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Appraisal of Korea Development Bank Korea

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CURRENCY EQUIVALENTS

US\$1	=	W 485
W 1	=	US\$0.0021
W 1 million	=	US\$2,062
W 1 billion	=	US\$2.06 million

ABBREVIATIONS

ADB	-	Asian Development Bank
AY	-	Arthur Young & Company
BOK	-	Bank of Korea
Exim Bank	-	Export Import Bank of Japan
FCIDC	-	Foreign Capital Inducement Deliberation Committee
IFD	-	Industrial Finance Debenture
IRF	-	Industrial Rationalization Fund
KDB	-	Korea Development Bank
KDFC	-	Korea Development Finance Corporation
KEB	-	Korea Exchange Bank
KECO	-	Korea Electric Company
KfW	-	Kreditanstalt für Wiederaufbau
KIC	-	Korea Investment Corporation
KIFC	-	Korea Investment and Finance Corporation
KIL	-	Korea Industrial Leasing Company Ltd.
MIB	-	Medium Industry Bank
NIF	-	National Investment Fund
OECD	-	Overseas Economic Development Fund, Japan
OSROK	-	Office of Supply, Republic of Korea
OP	-	Operational Program
RC	-	Readjustment Corporation
SAC	-	Shareholding Administration Committee
SAF	-	Shareholding Administration Fund
SFD	-	Special Finance Debenture
TDF	-	Tourism Development Fund
USAID	-	United States Agency for International Development

FISCAL YEAR

January 1 - December 31

KOREA

APPRAISAL OF

KOREA DEVELOPMENT BANK

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This report is based on the findings of an appraisal mission comprising Messrs. Zamir Hasan, Khalid Siraj and Rainer Ullmann that visited KDB in August 1974.

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CHART

Organization Chart as of December 31, 1974.

KOREA DEVELOPMENT BANK

BASIC DATA

1. Year of Establishment: 1954
2. Ownership: Government of Korea - 100%
3. Bank Group Assistance: None so far.
4. Operations:

	<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>
<u>Loans:</u>	<u>(billion Won)</u>			
Commitments:				
Domestic currency	47.1	140.7	94.5	128.9
Foreign currency	<u>13.2</u>	<u>13.3</u>	<u>10.6</u>	<u>24.3</u>
Total commitments	<u>60.3</u>	<u>154.0</u>	<u>105.1</u>	<u>153.2</u>
Disbursements:				
Domestic currency	47.1	140.7	94.5	128.9
Foreign currency	<u>1.9</u>	<u>4.8</u>	<u>9.2</u>	<u>15.5</u>
Total disbursements	<u>49.0</u>	<u>145.5</u>	<u>103.7</u>	<u>143.4</u>
<u>Investments:</u>				
Equity shares	7.5	23.4	3.0	10.7
Bonds and debentures	<u>0.7</u>	<u>0.4</u>	<u>0.9</u>	<u>1.7</u>
Total investments	<u>8.2</u>	<u>23.8</u>	<u>3.9</u>	<u>12.4</u>
<u>Guarantees issued</u>	<u>216.2</u>	<u>125.2</u>	<u>313.7</u>	<u>619.6</u>

5. Interest Rates: (as of December 31, 1974):

General loans	15.5% p.a.
Equipment loans for major and machine industries	12.0% p.a.
Operating fund loans for machine industries	12.0% p.a.
Loans from NIF	12.0% p.a.
Industrial Rationalization Fund loans	12.0% p.a.

BASIC DATA

Tourism Development Fund loans	7.5% p.a.
Special Government Fund loans	7.5% p.a.
Foreign Fund loans for major industries	
Equipment loans	10.0% p.a.
Operating fund loans	14.0% p.a.
Foreign Fund loans for other industries	15.0% p.a.
AID loans (3rd)	10.0% p.a.
KfW loans (3rd)	9.0% p.a.
ADB loans (3rd)	9.5% p.a.
Penalty charge	25.0% p.a.

6. <u>Earnings Record:</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>
Income before tax and provisions				
as % of average total assets	0.7	1.6	1.2	0.9
Net income (tax exempt) as %				
of average equity	2.4	3.7	2.5	2.9
Cost of term debt as % of average				
term debt	8.3	8.2	8.3	8.2
Financial expenses as % of				
average total assets	6.6	5.6	5.6	6.4
Administrative expenses as % of				
average total assets	1.5	0.9	1.0	1.0

7. <u>Financial Position (as of December 31)</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>	June 30 <u>1974</u>
Current ratio	2.6	5.1	4.1	3.9
Total debt/equity ratio ^{1/}	2.8	1.8	2.2	3.1
Long-term debt/equity ratio ^{1/}	2.6	1.7	2.1	3.0
Reserves and provisions as % of loan				
and investment portfolio	5.9	9.9	8.2	4.6

^{1/} Excluding guarantees from debt.

KOREA

APPRAISAL OF

KOREA DEVELOPMENT BANK

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

- i. This report recommends a loan of \$60 million to Korea Development Bank (KDB). It is by far the largest institution in Korea providing medium- and long-term capital to industry, both public and private. Directly and indirectly, KDB was involved in close to 40% of total fixed capital formation in Korea in 1973. Its loans outstanding to the manufacturing sector at the end of 1973 accounted for 40% of all medium- and long-term loans by the entire banking sector. Exports by KDB's clients in 1972 accounted for 41% of Korea's total exports of manufactures, and in the same year companies assisted by KDB provided a quarter of total industrial employment and output in the country. KDB's guarantee portfolio accounts for about 45% of Korea's total foreign term debt.
- ii. KDB is 100% Government owned, and its management is also appointed by the Government. The present Governor, who has held office since August 1972, is a former Vice-Minister of Finance. The Deputy-Governor and all the 7 members of the Board of Executive Directors have reached their present positions after long service with KDB. Both the management of KDB and its staff are experienced and competent.
- iii. KDB's operational procedures are well developed and clearly defined. Its appraisal standards are generally satisfactory although the appraisal of economic aspects of projects could be improved. However, a sample test showed its projects generally to have satisfactory economic rates of return. Supervision, procurement and disbursement procedures and practices are satisfactory. Operational planning is done through an annual Operational Program, subject to approval by the Government. KDB sets its operational policies independently, but within the broad economic policies and priorities of the Government. For large projects of national priority, for which the Government provides the funds, and for guarantee operations, the basic decisions are essentially taken by the Government although KDB does influence the project formulation and retains the right to refuse financing projects which in its judgement do not meet its standards and criteria. KDB has full autonomy for all projects which it finances from funds raised by itself independently of the Government, including those from international institutions. It is estimated that in the 18-months period ended June 30, 1974 projects referred to it by the Government accounted for somewhat less than 40% of total operations. There is no doubt that KDB will have complete independence and autonomy in making decisions regarding projects to be financed from the proceeds of the proposed loan.

iv. During its 20 years of operations, KDB's loan commitments have amounted to W 659 billion (\$1.4 billion equivalent) of which about 85% were committed during the past 6 years. KDB's foreign loan operations have increased since 1971, when it obtained its first loan from the Asian Development Bank. Foreign currency loans outstanding now amount to W 32.0 billion and account for 8% of total loans outstanding as of December 31, 1974. The average size of project loans to the public sector (which account for about two-thirds of total loans) is W 514.7 million (\$1.1 million equivalent), compared with W 67.4 million (\$139,000 equivalent) for loans to projects in the private sector. By sector, KDB's portfolio covers a broad spectrum. Geographically, KDB's portfolio follows the pattern of industrial distribution in Korea.

v. KDB's equity investments amount to W 65.9 billion (\$136 million equivalent) in 26 companies. Only one company is in the private sector; 25 companies accounting for about 85% of total investments are in the public sector. In some companies KDB's present holding amounts to more than 50% of the share capital. Except in two companies, KDB's holdings are intended to be temporary, to be sold as soon as KDB prudently can; KDB's policy in this respect is clearly stated and the performance matches the declared intentions (in 1974, KDB sold its holdings in 3 companies). KDB's investments are predominantly in the manufacturing sector.

vi. KDB's total outstanding guarantees amounted to W 1,311 billion (\$2.7 billion equivalent) as of December 31, 1974, of which 95% were external repayment guarantees. Decisions concerning external repayment guarantees are taken by a ministerial-level Government committee; KDB's input comes at an early stage in the form of a report to that Committee. In view of the extent of the potential risk to KDB arising out of its guarantee operations, an arrangement satisfactory to the Bank, has been worked out between the Government and KDB which provides, in brief, that if and when a default shall occur under any guarantee covered by the arrangement, the Government shall take the necessary steps in order to enable KDB to meet all obligations falling due under the default. The arrangement provides further that in case a defaulting client becomes bankrupt, the Government shall assume all obligations under the guarantee contract. A similar arrangement has also been worked out in respect of KDB's loans to Korea Electric Company.

vii. Before the Bank undertook its appraisal, KDB engaged Arthur Young & Company, a firm acceptable to the Bank, to audit its 1973 accounts. The auditors have given an unqualified report. KDB has a strong equity base with long-term debt to equity ratio of 3.0:1 without including guarantees in debt, and 11.7:1 if guarantees are included (December 31, 1974). Its liquidity position is also satisfactory. KDB's profitability has been low mainly because the Government does not intend it to be a profit-making institution, and its 'spread' on borrowed funds has been thin. KDB's loan portfolio is sound, with low arrears. Its equity investment portfolio is also maturing and has started producing a reasonable yield. Defaults by guarantee clients have been negligible.

viii. KDB has estimated that its commitments in the future will increase at an annual rate of 7%, and for 1975-76 will amount to W 385.7 billion (795 million equivalent). Considering the Government's overall growth rate targets and estimates of investment demand, KDB's business forecast is probably too conservative. KDB estimates that for the year 1975 and 1976, it would need to raise W 420.7 billion to meet the projected commitments and maintain a satisfactory liquidity position. Its plan to raise the needed resources, discussed in Chapter V, includes a loan of W 29 billion (\$60 million) from the Bank. KDB's financial position in the future should remain satisfactory.

ix. A loan of \$60 million to KDB is recommended. It would meet a part of KDB's capital needs. The Bank by lending to KDB could hope to achieve two objectives: (a) to provide finance for the manufacturing sector, which sector is expected to remain the principal engine of growth in the economy; and (b) to have a constructive influence on KDB as an institution. Although both public and private sector projects will be eligible, KDB proposes to use the Bank loan proceeds principally for projects in the private manufacturing sector, giving preference to export-oriented projects. KDB has given the Bank to understand that it would not use the proceeds of the proposed loan on just a few large projects; the amount of individual subloans will not normally exceed \$4 million each. A maximum debt/equity ratio of 5:1 is proposed with debt defined as all borrowings with a maturity of more than one year. A free limit of US\$750,000 is recommended, with an aggregate free limit of \$18 million. The minimum interest rate on subloans charged by KDB will be the Bank's rate plus 2%, with the exchange risk being borne by the sub-borrower.

x. During negotiations for the proposed loan, understandings were reached with KDB (recorded in agreed minutes) on the following:

- (a) amendments to the Policy Statement, to be adopted by the Executive Directors of KDB before the effectiveness of the proposed Loan (paragraph 2.03);
- (b) KDB's economic appraisal of projects and, more specifically, that it would introduce economic rate of return analysis for all sub-projects involving loans of US\$750,000 or more and to be financed from the proposed loan. The applicability of the economic rate of return analysis to projects to be financed from KDB's other resources will be discussed by the Bank's first Supervision Mission (paragraph 2.11);
- (c) arrangements between the Government and KDB regarding KDB's guarantee portfolio and its loans to Korea Electric Company (paragraph 3.17 and 4.12);

- (d) the loan proceeds will be used mainly to finance projects in the private manufacturing sector and the entire amount of the proposed loan will not be used to finance just a few large projects (the amount of individual sub-loans will not normally exceed US\$4 million each) (paragraph 5.13); and
- (e) in order to improve its debt service coverage, KDB will issue more long term debentures than short term issues as has been the case in the past, and the Government will assist KDB in this regard by being prepared to guarantee such issues (paragraph 5.10).

KOREA

APPRAISAL OF

KOREA DEVELOPMENT BANK

I. INTRODUCTION

1.01 The Government of Korea and Korea Development Bank (KDB) approached the Bank early in 1972 for financial assistance to KDB. An exploratory mission visited KDB in October 1972 and concluded that there were some problems which precluded an immediate loan. Throughout 1973 and the first half of 1974 discussions took place between the Government, KDB and the Bank to resolve these problems. By July 1974, sufficient progress had been made (including completion of a satisfactory audit of KDB's accounts by independent auditors acceptable to the Bank) to warrant an appraisal of KDB, which took place in August 1974. This report is based on that appraisal and recommends a loan of US\$60 million to KDB. The report deals with all aspects of KDB as an institution, its past operations and their impact on Korea's economy, its financial condition and prospects, and makes recommendations concerning the terms of the proposed loan. The Bank's latest report on the Korean economy is "Current Economic Position and Prospects of the Republic of Korea" (332-KO) dated February 20, 1974. An Economic Mission returned in February 1975 after completing field work in Korea; its report is under preparation. Those aspects of the economic situation which have direct relevance to KDB's operations are summarized in Annex I.

II. INSTITUTIONAL ASPECTS

Functions and Policies

2.01 Broad functions. KDB was established in 1954 after the Korean War as a wholly-owned Government Bank, under the Korea Development Bank Act, succeeding the Industrial Bank of Korea which had existed since 1918. KDB's primary purpose, as described in the Act (Article 1), is "to supply and administer funds, in conformity with Government policies, for financing necessary industrial projects with a view to expediting the industrial rehabilitation and economic development of the nation." It finances such sectors as electric power, coal mining, shipbuilding, iron and steel manufacture, (defined as "priority" industries by Presidential decree), and other industries to the extent that they are not adequately financed by other institutions. Over the years, KDB has shifted its focus from post-war rehabilitation to development projects. At the same time, it has widened the scope of its assistance from Won lending only to investment in equities, foreign currency loans and guarantees. In the late sixties and very early seventies, the Government transferred to KDB the shares it held in many industrial enterprises, and KDB began acting as a holding company.

These holdings have declined in the recent past, and will continue to decline, as KDB liquidates its majority holdings in line with the Government's policy of a gradual transfer of ownership to the private sector.

2.02 The KDB Act allows KDB to (i) extend long-term loans (in both local and foreign currency) to public and private industrial firms; (ii) make working capital loans (in Won) to enterprises that have obtained long-term loans from KDB or in the equity capital of which the Government or KDB has invested; (iii) subscribe, underwrite and/or guarantee debentures issued by public and private enterprises; (iv) make equity investments and underwrite share issues; (v) extend guarantees both in Won and foreign currencies; and (vi) provide foreign exchange banking services (since 1968) for its clients and Government enterprises. In addition KDB undertakes many non-financial activities which are described in paragraph 3.23.

2.03 Policies. KDB's operations are governed by the KDB Act, KDB's By-Laws, Operating manuals and a Policy Statement adopted by its Board in 1970 when ADB made its first loan to KDB. The Policy Statement summarized principles defined in the other documents and added a few new ones. It contained the usual "financial prudence" limits on its operations (e.g. limits on its total equity investments and equity investment in a single enterprise, limit on total assistance to any single enterprise, etc.). The Policy Statement, however, allowed KDB to exempt from the various limits all transactions relating to public sector and KDB invested projects. The Policy Statement also defined some of the limits in terms of KDB's net worth and "quasi-equity" 1/ whereas, in fact, KDB had no "quasi-equity". As of June 30, 1974, 64% of KDB's total portfolio was accounted for by the "exceptional" projects. Because of the exceptions allowed, the Policy Statement was an ineffectual instrument of policy guidance and control. The Policy Statement has been revised to provide for a uniform financial discipline for all projects for which KDB assumes the risk; the revised Policy Statement is given in Annex 2. Exceptions to the various limits would still be permitted on the basis of the merits of individual cases. KDB understands that the "exceptions" will have to be very few indeed and to be fully justified in each case. The revised Policy Statement also contains a new clause emphasizing that KDB shall follow sound financial policies, levy financial charges to cover not only all expenses but also to build adequate reserves, etc. The adoption of the Statement by KDB's Board is a condition of effectiveness of the proposed Bank loan.

Organization

2.04 Management. KDB is administered by a full-time Board of Executive Directors composed of the Governor, the Deputy Governor, both appointed by

1/ ADB and KDB understand this to mean those portions of Government loans which are repayable after 15 years. The loans are not subordinated, however.

the President of the Republic upon recommendation by the Minister of Finance, and seven directors appointed by the Minister of Finance upon recommendation by the Governor. The present members of the Board are listed in Annex 3. There is also an Auditor appointed by the Minister of Finance. The terms of office of Board members and the auditors are three years but they can be reappointed.

2.05 The present Governor Mr. Woun Gie Kim, who is 50, was appointed in August 1972. Most of his career has been spent in the various Government Departments dealing with fiscal and monetary matters. Just before his appointment as the head of KDB, he was the Vice-Minister in the Ministry of Finance. The Deputy Governor and all of the present Executive Directors have spent their entire career in KDB and its predecessor, the Industrial Bank of Korea. The Board is a competent and efficient body; all members are well qualified and experienced. The Governor is well-respected within KDB, in private financial and business circles, and in the Government. He provides effective leadership to KDB.

2.06 Staff. KDB has more than 1,700 staff members of whom about a third can be considered as professionals. About a fifth of the total staff is located in Branches or Representative Offices. About 200 of the professional staff have been trained in Japan or the USA. Most of the Department Directors have served KDB for many years. Seniority is the main consideration in staff promotion. Professional staff are recruited just after finishing school through open competitive examination and they usually spend their entire career with KDB. It has a systematic training and career development program for all staff.

2.07 Departmental and Branch Structure. KDB's organization is shown in Chart 1. The Head Office has twenty departments, and KDB has 9 Branches and 2 Representative Offices in New York and Tokyo. The departments can be grouped according to their functions as follows: (i) Line Operations: Loan Departments I and II, Foreign Loan Department, Foreign Guarantee Department, Share Holding Department, and Special Loan Department; (ii) Supporting: Technical Services Department, Business Analysis Department, Foreign Capital Department, Research Department, and International Department; (iii) Planning and Control: Planning Department, Business Control Department, Special Credit Control Department, Securities Department and Audit Department; (iv) General Administration: Personnel Department, General Services Department and Securities Control Department; and (v) Secretariat.

2.08 The first group of Departments is responsible for the main functions of processing all loan, investment and guarantee applications and for all follow-up work. The second group of Departments performs support functions such as surveying the financial condition of industrial enterprises in Korea and keeping a central credit file on all clients with loans in excess of Won 50 million, handling the management consultancy function of KDB, compilation of statistics and economic reports on domestic and international

developments and on any other subject proposed by management or other departments. The functions of the other three groups are implicit in the names of the Departments.

2.09 Branches. KDB has nine Branches, one in each of the eight mainland provinces, and a ninth branch recently opened in Ulsan. The Branches have responsibilities similar to those of the Loan Departments at Head Office for loans under their jurisdiction. The jurisdiction is determined, in general, according to the location of projects. Large, Government directed projects and foreign loans, however, are always handled at Head Office. Branches can approve loans at their own discretion up to a certain amount. (Normally they can approve loans to a total of Won 60 million within six months, but not more than Won 20 million per loan; these loans are mostly for short-term working capital requirements.) The two representative offices in Tokyo and New York were set up mainly for investment promotion and fund raising purposes. Two more representative offices are planned to be opened in Europe in the near future.

Procedures

2.10 Appraisal. Loan applications are submitted either through Branches or directly to Head Office; larger loans and foreign currency loans, however, are always processed at Head Office. Full appraisal is undertaken after "pre-screening" which includes a personal talk by the Department Director with the customer. In case imports of equipment and machinery are required, approval is also sought from the Ministry of Commerce and Industry which mainly reviews the need for imports. For guarantees, clients apply to KEB and the Foreign Capital Inducement Deliberations Committee. The FCIDC sends the application to KDB for analysis by its Technical Services Department. On the basis of the resultant assessment, the FCIDC takes a decision and conveys it to KDB. If the decision is favorable, KDB gives the guarantee after obtaining a counter guarantee from KDB.

2.11 Except as noted later in this paragraph, KDB's appraisals are usually thorough and systematic, and cover all major aspects of the project concerned. Technical and financial appraisals are usually quite satisfactory. Appraisal of economic aspects at the prescreening stage consists of a test for eligibility according to priorities listed in the KDB Act; at the detailed appraisal stage it consists of an analysis of partial indicators such as value added, foreign exchange savings or earnings and employment creation. At present KDB does not undertake the calculations of effective rate of protection or economic rate of return. (For a commentary on the impact of past operations, see Annex 10). The staff does have the professional competence to undertake fairly sophisticated economic analysis, and KDB has undertaken to start doing economic rate of return analysis for all subprojects requiring a loan of US\$750,000 or more and to be financed from the proposed loan. The question of expanding the applicability of the economic rate of return

analysis to other projects (whether or not financed by the proceeds of the proposed Bank loan) will be decided during the visit of the first Bank Supervision Mission after reviewing the experience gained by KDB in using the economic rate of return analysis for all Bank subprojects involving financing of US\$750,000 or more.

2.12 For the projects for which the Government rather than KDB takes the basic decisions (Government-directed projects), KDB's appraisals largely consist of checking and supplementing the evaluation work done by the ministries concerned. For very large projects such as loans to Korea Electric Company and Pohang Steel Company, KDB does not prepare an appraisal report but is consulted by the Government at the time of project formulation. (see also paragraph 2.18).

2.13 Follow-up. KDB's follow-up procedures are thorough and well organized. Specific guidelines have been established to handle supervision which is undertaken by the operational departments at Head Office or the Branches, depending on the location of projects (see paragraph 2.10). Appraisal officers normally are also responsible for the follow-up. During the construction stage the Technical Services Department conducts spot checks and upon completion prepares a completion report. Field visits are conducted systematically for completed projects, including occasional field audits. Clients have to submit periodic reports and the KDB management is kept informed of the progress of projects. Projects in arrears for more than six months are transferred to the Special Loan Department for assistance which may include the deputation of specialists to the troubled project for several months. If the condition of the enterprise does not improve and there is no hope of progress or if the client is in default on four consecutive instalments due, then the project is transferred to the Readjustment Corporation (See Annex 8) which takes the necessary legal action for recovery of amounts due.

2.14 Procurement and Disbursement. Procurement and Disbursement procedures are well designed, are strictly enforced and are satisfactory. Procurement in the case of foreign loans is done in three ways: (1) through OSROK (Office of Supply, Republic of Korea), (2) by the sub-borrower through formal competitive bidding and (3) by the sub-borrower without competitive bidding. 1/ If the third method is used, KDB checks whether the clients' selections were appropriate and reasonably priced.

2.15 In the case of a domestic currency loan, KDB opens a credit control account to which the full loan amount is credited as soon as the loan is formally committed; amounts are considered as fully disbursed at this stage. Actual payments are then made from that account as expenditures are certified and reimbursed, usually after plant visits and checking of documents. The established disbursement procedures are effective in making sure that withdrawals from the credit control account are made only for the purposes of the loan. For foreign currency loans, KDB follows the procedures laid down by the lending institutions. KDB should face no particular problem in

1/ Projects accounting for 10% of foreign loans have used this method.

observing the Bank procedures as it is already familiar with similar procedure prescribed by ADB.

2.16 Operational planning. Within the framework of its long-term plans, KDB does its detailed operational planning on an annual basis by preparing an Operational Program (OP) which is a requirement under the KDB Act, and which has to be approved by the Government. The Operational Program is essentially a statement of projected sources and uses of funds in the following year. On the "uses" side, the input comes from the operating departments and branches which project demand from existing or new clients, and from various Government ministries which propose specific projects for financing by KDB. The sources section details how KDB expects to raise resources to meet the projected uses, what KDB expects to receive from the national budget, (which becomes a commitment by the Government when it approves the Operational Program), how much it plans to raise by issuing IFDs, how much from the various funds (e.g. National Investment Fund, Rationalization Fund, etc.), how much by borrowing from foreign sources, etc. The Operational Program for 1974 is given in Annex 4.

Relations with Government

2.17 As the sole shareholder of KDB, the Government appoints the Board of Executive Directors, including the Governor. However, all the Executive Directors, except the Governor, have always been appointed by promotion from within KDB, ensuring that the Board is composed of experienced professionals. KDB's policies are set by its Board independently within the framework of overall economic policies and priorities set by the Government as expressed through such instruments as the Five-Year Plans. The Government exercises overall control of KDB through the mechanism of annual Operational Programs (paragraph 2.16). Changes in KDB's Operating Manual, By-laws and annual budget are also subject to Government's approval. The Government may also effect basic changes in KDB's functions by amending the KDB Act, as it did to enable KDB to give guarantees (paragraph 3.14).

2.18 In its decision making process, KDB is not entirely independent. For very large projects of national priority for which the Government also provides the needed resources, the basic decision is taken by the Government. However KDB retains the right to refuse to finance any project which it does not judge to conform to its standards and criteria. KDB has full autonomy in investment decisions on all projects which it finances from funds which it raises independently of the Government (including those from international institutions with Government guarantees). As for guarantee operations, KDB's input comes at an early stage when it examines the proposals at the request of the Economic Planning Board (paragraph 2.10), and a separate arrangement has been made in respect of these operations (paragraph 3.17). It is estimated that in the 18 month period ended June 30, 1974, projects referred to KDB by the Government accounted for 39% of total operations. On the basis of KDB's experience in the use of funds from international institutions (ADB, KFW, AID), there is no doubt that KDB will have complete independence and autonomy in making decisions about projects to be financed from the proceeds of the proposed Bank loan.

2.19 Working relations between KDB and the Government are close and cordial. The Governor of KDB sits on various ministerial level committees; other staff represent KDB on lower level committees. KDB's professionalism is respected by the Government and it is not infrequent for KDB to receive requests for advice on specific subjects.

III. OPERATIONS AND RESOURCES

Summary of Operations

3.01 KDB's financial assistance may be classified in three major categories: (a) loans in domestic and foreign currencies for equipment financing and working capital; (b) investments in equity shares, corporate and municipal bonds and debentures; and (c) guarantees in domestic and foreign currencies. KDB finances projects in both the private and public sectors. The following summary indicates the magnitude and composition of KDB's operations in the past six years (billion Won):

	<u>1969</u>	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>
Loan Commitments:						
Domestic Currency	40.6	42.4	47.1	140.7	94.5	128.9
Foreign Currency	<u>2.6</u>	<u>3.7</u>	<u>13.2</u>	<u>13.3</u>	<u>10.6</u>	<u>24.3</u>
Total Loans	<u>43.2</u>	<u>46.1</u>	<u>60.3</u>	<u>154.0</u>	<u>105.1</u>	<u>153.2</u>
Investments in:						
Equity Shares	14.5	21.4	7.5	23.4	3.0	10.7
Bonds and Debentures	<u>2.6</u>	<u>1.8</u>	<u>0.7</u>	<u>0.4</u>	<u>0.9</u>	<u>1.7</u>
Total Investments	<u>17.1</u>	<u>23.2</u>	<u>8.2</u>	<u>23.8</u>	<u>3.9</u>	<u>12.4</u>
Guarantees Issued:						
Domestic Currency						
Guarantees	37.9	26.6	19.9	12.2	66.5	28.1
Foreign Currency						
Guarantees	<u>128.7</u>	<u>148.2</u>	<u>196.3</u>	<u>113.0</u>	<u>247.2</u>	<u>591.5</u>
Total Guarantees	<u>166.6</u>	<u>174.8</u>	<u>216.2</u>	<u>125.2</u>	<u>313.7</u>	<u>619.6</u>
Total Commitments	<u>226.9</u>	<u>244.1</u>	<u>284.7</u>	<u>303.0</u>	<u>422.7</u>	<u>785.2</u>

In addition to its financial activities, KDB also renders various non-financial services which are described in paragraph 3.23.

Lending Operations

3.02 Trend of commitments. KDB's loan commitments, disbursements, repayments and amounts outstanding are summarized in Annex 5. During its twenty years of operations, KDB's total loan commitments have amounted to W 659 billion (\$1.4 billion equivalent), of which over 85% were committed during the six years ended December 31, 1974, reflecting a significant acceleration in KDB's lending in recent years. During this six year period, loan commitments have shown a steadily rising trend. However, loan commitments in 1972 were exceptionally large because of the direct impact on KDB's operations of the economic, fiscal and monetary measures taken by the Government in that year (Emergency Decree of August 3, 1972) as a result of which there was a sudden jump of W 42.31 billion in KDB's loan commitments.

3.03 Foreign currency loans. As of December 31, 1974, total outstanding loans amounted to W 425.69 billion (\$878 million equivalent) relating to 2,070 projects. Domestic currency loans (W 393.67 billion or \$ 812 million equivalent for 1,773 projects) accounted for 92% of total outstanding loans, while foreign currency loans (W 32.0 billion or \$ 66 million equivalent for 297 projects) accounted for the remaining 8%. KDB started its foreign currency lending operations in 1960 when the Government allocated to it an AID loan. KDB's foreign currency loans have increased significantly since KDB obtained its first loan directly from ADB in 1970; outstanding foreign currency loans increased by about five times from W 4.9 billion equivalent as of December 31, 1970 to W 32.0 billion as of December 31, 1974. Despite this rapid increase, the proportion of foreign currency loans in KDB's total loan portfolio did not rise much because domestic currency loan commitments were also increasing rapidly during the period. All foreign currency sub-loans are for equipment purchases and most of them are made from credits obtained from international institutions; loans obtained from foreign commercial banks are mostly used in making domestic currency loans, with the exchange risk borne by the sub-borrower.

3.04 Short-term loans. Of the outstanding amount of domestic currency loans, W 53.21 billion (1,250 projects) were working capital loans (for up to one year) and W 340.46 billion (523 projects) for capital goods or equipment loans. KDB makes working capital loans only to its long-term borrowers, Government projects, or projects which KDB itself controls or manages. The objective behind providing working capital (operating) loans is to ensure that KDB-financed projects and Government projects do not run into operating difficulties due to paucity of short-term funds. KDB does not compete with commercial banks.

3.05 Features of loan commitments. Annex 6 gives an analysis of loan commitments as at December 31, 1973.^{1/} About 33% of outstanding loans by amount related to private sector projects and 67% to public sector projects.

^{1/} Analysis of loan commitments is for the year ended December 31, 1973 as detailed data for 1974 is not yet available.

In terms of number of projects, the picture is quite different: 80% of loans have gone to the private sector and 20% to the public sector. This is explained by the fact that Government promotes and operates only large industrial projects which are judged to be beyond the financial capacity of the private sector. Consequently, the average size of loans made to the public sector (W 514.7 million or \$1.1 million equivalent) is much higher than the average size of loans to the private sector (W 67.4 million or \$139,000 equivalent). Large Government projects have heavily influenced the size distribution of KDB loans, e.g. only 15% of its loans exceeded W 200 million each by number but such loans account for 78.5% of the total outstanding loans by amount.

3.06 About two-thirds of the outstanding loan amount relates to new projects. By sector, KDB's loan portfolio covers a broad spectrum. The two largest recipient sectors are power generation (38.5%) and manufacturing (38.2%) followed by transportation (7.8%), banking and insurance (5.9%), mining and quarrying (4.9%), construction (3.4%) and miscellaneous industries (2.3%). If KDB's loans to Korea Electric Company are excluded (see paragraph 4.12), manufacturing would account for 61.3% of the total loan portfolio. Within the manufacturing sector, the portfolio appears well diversified with fabricated metal products and machinery manufacturing taking the largest share (27%) followed by basic metals (22%), chemicals and petroleum (16%) and others (20%). Geographically, KDB's loan commitments have followed the pattern of industrial location in Korea. The Seoul and Busan cities have accounted for about 53% of total KDB loan commitments. With increasing Government emphasis on wider geographic dispersal of new industrial investment, KDB should achieve a better regional spread in the future; no quick change in regional distribution of its overall portfolio can be expected, however.

3.07 KDB's interest rates. As discussed in Annex 1, interest rates in Korea are controlled by the Government. Prevailing interest rates in Korea and those charged by KDB are given in Annex 1B and 1C. The general interest rates on equipment loans in domestic currency is 15.5% and that on foreign currency loans is 9-10.5% with the exchange risk assumed by the subborrower. Considering the present and estimated rate of inflation for the foreseeable future and currently estimated opportunity cost of capital in Korea, the Bank has informed the Government that the current rates are low. A dialogue on this matter involving KDB, the Government and the Bank will be resumed in the light of the findings and conclusions of the Basic Economic Mission which has just returned from Korea. In the meantime, KDB will on-lend the proceeds of the proposed Bank loan at a rate two percentage points above the Bank's lending rate.

Investment Operations

3.08 A summary of KDB's investment operations during the last six years is given in Annex 7. KDB's total investment portfolio as of December 31,

1974 stood at W 76.0 billion (\$157 million equivalent) of which about 87% was in the form of equity shares (W 65.9 billion) and 13% in bonds and debentures (W 10.1 billion). During this period, equity investments increased at an annual rate of 49%. The importance of bonds and debentures in KDB's total investments has steadily declined. Most of the bonds and debentures held by KDB were issued by various municipalities.

3.09 Mode of acquisition. KDB has acquired its equity investments through (a) direct cash subscriptions, (b) conversion of loans into shares, and (c) transfers of shares in industrial companies from the Government as contributions to paid-in capital. Total equity investment of W 65.9 billion as of December 31, 1974, was acquired as follows:

	<u>Billion Won</u>	<u>%</u>
Direct cash subscriptions	43.1	65.4
Conversions of loans	5.4	8.2
Transfers from Government	<u>17.4</u>	<u>26.4</u>
	<u>65.9</u>	<u>100.0</u>

It is significant that during the three years ended December 31, 1974, net outstanding investment in shares acquired through direct cash subscriptions and conversions of loans increased by 158% and 56% respectively while there was a net decline of 74% in the total amount of shares transferred from the Government. This trend is likely to continue in the future.

3.10 Extent of ownership. Out of the total of 26 companies in which KDB has an equity investment, its shareholding in 7 companies amounts to more than 50% of their respective paid-in capital. Such companies account for 35% (W 23.3 billion) of KDB's total equity investments. In 6 of these 7 companies, KDB has invested either directly or through conversion of loans and in one company investment was acquired partly through direct investment and loan conversion and partly through share transfers from the Government. Five companies accounting for 91% of total investment in those 7 companies, are in the manufacturing sector, including a steel mill, an electric machinery making project and a fertilizer project. All these projects fall within the category of high priority projects. The two non-manufacturing companies - Korea Industrial Leasing Company (KIL) and Readjustment Corporation (RC) - both 100% owned are in effect corporate extensions of KDB operations. KIL is engaged in the business of leasing industrial machinery and equipment, while RC acts as a collection agent for KDB as well as other financial institutions in the country. Some aspects of the constitution and operations of these two companies are described in Annex 8. Except for KDB's investments in KIL and RC, investments in all other companies are of a temporary nature to be sold as soon as KDB prudently can, and most of them were made to safeguard its existing investments (including loans) by taking over majority ownership to control their management. During 1969-1974, KDB sold its holdings in 10 companies for a total amount of W 4.9 billion.

3.11 KDB Shareholding Act and Shareholding Administration Fund. The KDB Shareholding Act which also created the Shareholding Administration Fund (SAF), was approved and promulgated in August 1969. Its purpose was to give KDB closer and more effective control over the management and finances of companies in which KDB had majority holding (excluding KIL and RC) with a view to ensuring their sound growth. Under the provisions of this Act, a Shareholding Administration Committee (SAC) was set up comprising nine members including the Ministers of Economic Planning Board (also Chairman of SAC), Finance, Agriculture and Forestry, Commerce and Industry, Construction and Transportation, the Governor of KDB and two independent persons from the public with knowledge of and background in business administration. The SAF, maintained within KDB, represents a separate accounting of all investments in KDB-controlled enterprises, funds generated by their sales and dividend collections. The innovative mechanism set up by the Shareholding Act has given an opportunity to KDB, on the one hand to keep a close watch on the management and operations of the companies brought within its ambit and, on the other hand, effectively to influence the various Government policies directly affecting the operation of such companies. This unusual arrangement has produced good results; most of these companies have shown considerable improvements in their operational performance (see paragraph 4.11) enabling SAC so far to liquidate KDB's shareholding in 10 companies of the 17 companies brought within its purview.

3.12 Exposure in subsidiaries. KDB's investment in 7 companies exceeds 50% of their respective paid-in capital. Two of these, KIL and RC, are in effect corporate extensions of KDB operations. The investment in the other 5 companies does not constitute unduly high risk to KDB's portfolio. This assessment is based on more factors than one: the investments are temporary and KDB has a firm policy of selling its shareholdings as soon as it prudently can (it sold three subsidiaries in 1974); the invested companies are effectively supervised both by KDB and the Government through SAC; commercially the investment portfolio has started yielding reasonable returns (in 1974, the yield was 7.6%), and the total investment in the subsidiaries (other than KIL and RC) has been reduced over the years to less than 5% of KDB's total assets (excluding guarantees). It is expected that KDB's exposure in these 5 companies will be gradually reduced as KDB sells its shareholdings. The revised Policy Statement guards against new acquisitions in excess of 50% of the total share capital of the invested companies.

3.13 Features of equity investments. An analysis of KDB's equity investments is given in Annex 6. All companies in which KDB has invested, except one, belong to the public sector. In terms of amount, 85% of total investment has been made in Government projects and the remaining 15% in the private sector. The preponderance of public sector projects in its equity investment portfolio reflects KDB's policy of investing in large and complex projects of national importance generally beyond the capacity of the private sector and the fact that part of the portfolio has been transferred by the Government to KDB. Manufacturing is the predominant sector in KDB's equity investment portfolio, accounting for about 88% of the total. Within the

manufacturing sector, 52% has gone to basic metals projects such as steel and aluminum, 39% to fertilizer and other chemical projects, 8% to machinery manufacturing projects and the balance of 1% to miscellaneous industries. About 80% of total equity investment is represented by four transactions of which three were transfers from the Government. The average size of each individual investment transaction is W 1.33 billion while average size of total investment in each company is W 2.0 billion.

Guarantee Operations

3.14 KDB started its guarantee operations after an amendment to the KDB Act in December 1961 which enabled it to issue repayment guarantees in domestic currency only. In July 1968 KDB was authorized to issue repayment guarantees to Korea Exchange Bank (KEB) against foreign currency loans. Finally, in September 1972 KDB was authorized to issue foreign exchange guarantees directly to foreign creditors. The risks involved in guarantees issued directly to the foreign creditor or to KEB are identical.

3.15 KDB's guarantee operations during the 1969-1974 period are summarized in Annex 9. In the past six years ended December 31, 1974, total guarantees issued by KDB amounted to W 1,616.1 billion or \$3.3 billion equivalent (W 1,424.9 billion in foreign currency and W 191.2 billion in domestic currency), while guarantees totalling W 480.4 billion (\$1.0 billion equivalent) were redeemed. On the whole, total outstanding guarantees increased by almost 650% - from W 175.4 billion as of January 1, 1969 to W 1,311.1 billion as at December 31, 1974 of which 95% were external repayment guarantees (those issued against foreign suppliers' credit arranged by Korean entrepreneurs). Most of these guarantees were issued to KEB which in turn issued its repayment guarantees to the foreign creditor (paragraph 2.10). KDB's external repayment guarantees account for about 45% of Korea's total foreign term liabilities.

3.16 Features of outstanding guarantees. The main features of KDB's outstanding guarantees as of December 31, 1973 are given in Annex 6. The major part (53.8%) of guarantees has been issued for private sector projects. This is in contrast to KDB's other forms of assistance such as loans and investments, of which only 33% and 14.6% respectively have gone to the private sector. In terms of the number of guarantees, the share of the private sector is even higher (70%). Another feature is that a major part (61.3%) of guarantees has been issued to existing companies, whereas the major part of loans (64.2%) has gone to new projects. This reflects KDB's policy of giving preference to established companies in considering requests for guarantees. Over 92% of KDB guarantees have gone to the electricity (32.3%) and manufacturing (60.2%) sectors. In the electricity sector almost all guarantees have been issued on behalf of one client, Korea Electric Company (KECO), which is Korea's national power generating and distribution company, controlled by the Government (paragraph 4.12). Within the manufacturing sector, chemicals and petroleum (30%), fabricated metal products (22.4%), textiles (15.3%), basic metals (14.1%) and non-metallic mineral products (14%) are important sub-sectors. The geographical distribution of KDB guarantees

is almost identical to that of loans. Average size of guarantees issued is W 1.0 billion. There are 147 guarantees issued in excess of W 2.0 billion each (18.7% of total) but these represent 84.5% of the total amount guaranteed; public sector projects (steel mills, KECO, oil refinery, fertilizer plants) account for most of the largest guarantees.

3.17 Guarantee operations and KDB's creditworthiness. KDB's guarantee operations are over two and half times the size of its loan and investment operations combined, and outstanding guarantees more than nine times its net worth. If guarantees are included in its debt, KDB's long term debt/equity ratio would be 11.7. Moreover, some of the guarantees issued by KDB are very large indeed, e.g., as of June 30, 1974, the fourteen largest guarantees represented almost 70% of total outstanding guarantees as of that date and the range was W 11.2 billion to W 201 billion (\$28 million to \$500 million). Although the delinquency rate so far has been negligible, the existing potential risk to KDB is considerable and seriously affects the judgement of KDB's long-term creditworthiness. (Moreover, the guarantee fee of 0.4 to 0.6% on outstanding guarantees common to all banking institutions in Korea, appears to be unduly low.) Yet a complete elimination of KDB's guarantee function, or even a severe curtailment of it, would not be in the larger interests of the country. Korea needs and will long continue to need large inflows of foreign capital and KDB is in a good position to encourage such inflows by its guarantee function. An arrangement, satisfactory to the Bank, has now been worked out between the Government and KDB, covering more than 80% of total outstanding guarantee portfolio, which provides, in brief, that if and when a default shall occur under any guarantee covered by the arrangement, the Government shall take the necessary steps in order to enable KDB to meet all obligations falling due under the default. The arrangement provides further that if and when the Government and KDB reach the conclusion that the defaulting party has become bankrupt, the Government shall assume all future obligations of KDB under the guarantee contract. In view of this Guarantee Release Arrangement, it is appropriate, for the purpose of limiting KDB's borrowing powers (see paragraph 4.07), to exclude the guarantees from the definition of debt which are covered under the Arrangement.

Economic Impact of KDB's Operations

3.18 The economic impact of KDB's operations is examined in Annex 10, "KDB's Role in the Economy", and summarized in the following paragraphs.

3.19 KDB in perspective. KDB is by far the largest long-term lending institution in Korea accounting for 46% of all medium- and long-term loans by the banking sector outstanding at the end of 1973. It directly financed 8% of total fixed capital formation, and 16% of total fixed investment in the manufacturing sector, in 1973. As KDB on an average finances about 30% of total project cost, and if guarantees are included, KDB was involved in close to 40% of total fixed investment in the country in 1973. Its guarantee

portfolio at the end of 1973 (US\$1.5 billion equivalent) accounted for 38% of Korea's total foreign medium- and long-term debt and in 1973 its clients accounted for 41% of Korea's total exports of manufactures.

3.20 Employment and output. In 1972, enterprises assisted by KDB accounted for about one fourth of total industrial employment and output in the country. As some of KDB-assisted projects are very capital-intensive (steel mills, petrochemical plants), the average cost per job for 109 projects completed between 1970 and 1973 was US\$14,000 compared to a national average of US\$4,200 equivalent in 1972; excluding the two steel plants and three petrochemical plants from the sample, the average cost per job would decrease to US\$4,100 equivalent. By the end of 1972, projects assisted by KDB had created 250,000 new jobs and, in 1972, their output was valued at US\$1.2 billion equivalent (25% of total industrial output in that year).

3.21 Resource mobilization. KDB's resource mobilization effort from sources other than the Government has been impressive. Of its total resources as of December 31, 1974, almost 37% (US\$479 million equivalent) were raised independently. Funds raised independently ^{1/} include those raised in the domestic capital market (51.8%), borrowings from international institutions (12.5%) and borrowings from international capital markets (25.9%). Early in 1974, KDB borrowed US\$80 million from a consortium of foreign banks without Government guarantee. In October 1974, KDB borrowed US\$19 million equivalent from Abu Dhabi and expects to tap the Middle East capital market again in 1975. At the project level, KDB has been instrumental in raising resources indirectly by persuading some of its clients to meet a higher proportion of total project costs from their own resources than they envisaged initially.

3.22 Economic rates of return of KDB projects. KDB does not routinely calculate the economic rates of return (ERR) of the projects it finances. However, the ERRs of a sample of 28 projects were found to be very satisfactory, averaging 30% with only four below 17%. The average ERR was higher than the average financial rate of return (FRR) although in 3 cases the FRR was higher than the ERR. In all cases the ERR was higher than the current estimate of the opportunity cost of capital in Korea. The satisfactory ERRs are not surprising because Korea's industrial development policies and priorities have been highly successful, and by adhering to them closely KDB has been able to finance economically good projects.

3.23 Other contributions. KDB has been performing an important function by temporarily holding a majority interest in Government sponsored projects, and subsequently selling the shares to private investors after improving project performance. It has helped broaden the entrepreneurial base in Korea by financing projects proposed by persons without previous industrial experience. KDB also carries out, on a regular basis, statistical surveys, conducts economic and industrial research, undertakes engineering surveys and business analyses and provides managerial assistance to its projects. In addition, KDB has often been called upon by the Government to

^{1/} Funds provided by retained earnings accounted for 12.9%.

give its opinion on major policy issues, and it has assisted in many Government projects and programs. KDB's management is regularly represented on many important Government committees such as the Economic Cabinet Meeting, the FCIDC, the Industrial Rationalization Council, the Advisory Committee for Economic Planning and the NIF-Management Council.

Resources

3.24 As of December 31, 1974, KDB's total resources amounted to W 628.7 billion (\$1.31 billion equivalent) of which W 527.4 billion (\$1.1 billion equivalent) or 83.9% were raised in domestic currency and W 101.3 billion (\$208 million) or 16.1% in foreign currency. A detailed description of KDB's resources and the main terms and conditions of borrowed funds are given in Annexes 11, 12 and 13.

3.25 KDB's equity is its single largest source of funds. The authorized capital is W 300 billion. The Government's initial subscription to KDB's paid-in capital made in 1954 was W 10 million; the present paid-in amount is W 119.7 billion (December 31, 1974). Increases in paid-in capital since the beginning of 1969 have been much larger (W 99.8 billion) than in the earlier 15-year period (1954-1968). Reserves and retained earnings amounted to W 22.9 billion as of December 31, 1974.

3.26 KDB's domestic currency borrowings can be divided into three categories: (a) direct borrowings from the Government, (b) borrowings from Government institutions or funds (such as NIF and IRF) and (c) borrowings from the general public. Direct borrowings from the Government (W 136.6 billion as of December 31, 1974 representing 26% of total domestic resources) mainly come in the form of budgetary allocations made on the basis of KDB's resource requirements set forth in its yearly OP (paragraph 2.17). A part of the funds lent by the Government is for specified projects and/or sectors, while the rest is available to KDB for its normal operational purposes. Borrowings from Government institutions and funds (SFDs, NIF, IRF and TDF) amounted to W 118.9 billion (23% of total domestic currency resources) as of December 31, 1974. These funds have been provided to KDB under the Government's various plans to provide funds to specific sectors of the economy. Borrowings from the public include IFDs and deposits (W 120.2 billion or 23% of total domestic currency resources as of December 31, 1974) raised independently by KDB.

3.27 Until 1969 KDB was completely dependent on the Government for its foreign currency resources. In 1970 KDB obtained its first direct foreign currency loan (\$10 million from ADB). Since then over 95% of foreign currency resources have been obtained directly by KDB and 5% were obtained through the Government. As a result, the proportion of resources - in foreign as well as domestic currencies - received from the Government declined from 71% in 1969 to 63% in 1974. The change in the source of funds was much more pronounced during the latest 2 years period ended December 31, 1974 when only 54% of total new resources came from the Government and 46% were independently obtained by KDB. A statement of

resources received annually from the Government and raised independently by KDB since January 1, 1969 is given in Annex 13.

3.28 In lending its foreign exchange funds, KDB does not assume foreign exchange risk. Even when it uses its foreign exchange resources to make loans in domestic currency and when it makes loans from "revolving funds", KDB protects itself against the exchange risk through a "maintenance of value" clause in its loan agreements with sub-borrowers. On loans received from OECF and Ex-Im Bank, Japan, amounting to W 21.6 billion, KDB makes a provision amounting to 1.5% of interest income from sub-loans to cover the exchange risk; excess of actual losses, if any, is to be met by the Government.

3.29 Out of total resources of W 628.7 billion, KDB's disbursements up to December 31, 1974 had amounted to W 569.2 billion giving a net resource availability of W 59.5 billion for further disbursements. After accounting for KDB's undisbursed commitments (W 14.3 billion) the net resources available for further commitments amounted to W 45.2 billion as of December 31, 1974. Details of the long-term resource position as of June 30, 1974 are given in Annex 14.

IV. FINANCIAL CONDITION AND PORTFOLIO EVALUATION

Basis of Accounting

4.01 As is conventional in most other financial institutions in Korea, KDB states income on an actual receipts basis and expenses on an accrual basis in its annual accounts. However, financial statements for 1972 and 1973 were prepared by independent external auditors, Arthur Young & Co. (AY) (paragraph 4.08), and are based on an accrual basis for both expenses and income. Consequently, KDB's financial position and performance shown in respect of 1972 and 1973 are better than was originally displayed by the financial statements prepared by KDB itself. 1/

Financial Performance

4.02 KDB's income statements for six years ended December 31, 1974 are summarized in Annex 15. Some highlights are given below (billion Won): 1/

1/ On the accrual basis, net income is higher by W 1.0 billion and W 0.2 billion for 1972 and 1973 respectively. Income for 1969, 1970, 1971 and 1974 is on an actual receipts basis and expenses on an accrual basis.

Years ended December 31	<u>1969</u>	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>
Gross income	10.5	15.7	19.8	25.8	32.7	43.0
Financial expenses	<u>6.6</u>	<u>11.1</u>	<u>14.8</u>	<u>17.8</u>	<u>23.7</u>	<u>33.5</u>
Gross margin	3.9	4.6	5.0	8.0	9.0	9.5
Administrative expenses & provision for bad debts	<u>2.6</u>	<u>3.1</u>	<u>3.5</u>	<u>4.1</u>	<u>5.4</u>	<u>5.4</u>
Net Income	<u>1.3</u>	<u>1.5</u>	<u>1.5</u>	<u>3.9</u>	<u>3.6</u>	<u>4.1</u>
Gross earnings as % of average total assets	8.0	9.1	8.8	8.1	7.7	8.3
Net income before provisions as % of average total assets	1.0	0.9	0.7	1.6	1.2	0.8
Net income as % of average equity	4.1	3.0	2.4	3.7	2.5	2.9

4.03 In absolute terms KDB's profitability rose sharply in 1972 as a result of record business operations in that year. KDB's "spread" also improved in that year as a result of a restructuring of KDB's financial expenses and income after the promulgation of the Emergency Presidential Decree of August 1972. The slight fall in KDB's net income in 1973 (W 3.6 billion as compared to W 3.9 billion in 1972) was caused by a negative spread on KDB's lending operations and an increase in administrative costs (from W 2.8 billion in 1972 to W 4.1 billion in 1973). During the past six years, total administrative expenses increased by about 109%. Related to total assets, however, administrative expenses declined from 2.0% in 1969 to 1% in 1974, since KDB's total assets increased by 309%.

4.04 KDB's overall profitability is low mainly because the sole shareholder, the Government of Korea, does not regard it as primarily a profit making institution, but as a development agency. KDB's "spread" ^{1/} has always been small, ranging between a maximum of 2.8% to a minimum of - 0.5% during the last six years. If equity funds are included, the overall spread would be, on average, 3.5% annually for the last 6 years. KDB's profitability has also been adversely affected in the past by a marginal yield on its equity investments (paragraph 4.11) and the rather meager income from its guarantee operations (paragraph 3.17).

4.05 KDB does not make provisions for bad and doubtful accounts; instead it recognizes actual bad debts as and when they arise. During the past six

^{1/} Income on loan portfolio as % of average loan portfolio minus cost of term debts as % of average term debts.

years, KDB wrote off debts only twice; W 1.63 million and W 64 million in 1973, and 1974 respectively. However, the external auditors, while auditing the accounts for 1972 and 1973 independently estimated and proposed provisions for doubtful debts. These provisions amounting to W 1.26 billion for 1972 and W 1.27 billion for 1973 represented 0.53% and 0.40% of outstanding loan portfolio as at the end of each of those years.

Financial Position

4.06 KDB's balance sheets as of December 31, 1969 through 1974 are summarized in Annex 16, and some indicators of financial position and operational performance are given in Annex 17. Total assets increased by 309% (51% per annum) from W 142.9 billion as of December 31, 1969 to W 584.4 billion as of December 31, 1974. Loan portfolio (W 425.7 billion) accounted for 73% of total assets as of December 31, 1974, while its corresponding share six years ago was 67%. Simultaneously, investment portfolio as a percentage of total assets declined from 24.1% to 13.0%, despite a 120% increase in the absolute amount of the investment portfolio. On the resources side of the balance sheet, long-term debts increased by 348% from W 94.2 billion in 1969 to W 422.0 billion in 1974. Foreign currency borrowings increased from W 3.4 billion to W 64.0 billion, while their share in total long-term debts increased from 3.6% to 15%. KDB's equity increased by 284% of which 87% was in the form of contributions to paid-in capital and 13% in the form of increase in retained earnings. KDB's current position is highly satisfactory with a current ratio of 3.9.

Debt/Equity Ratio

4.07 There is no statutory limit on KDB's overall debt/equity ratio, nor does KDB's Policy Statement place any restriction on its borrowings. The KDB Act, however, stipulates that at any time the aggregate of outstanding amounts of IFDs and KDB guarantees shall not exceed ten times its net worth. KDB is within this limit, the actual ratio being 9.8 as of December 31, 1974. As of December 31, 1974 KDB's long-term debt/equity ratio was 3.0:1. After consolidating its accounts with those of its two permanent subsidiaries (Readjustment Corporation and Korea Industrial Leasing Company) KDB's debt/equity ratio becomes 3.3:1. Guarantees have been excluded from the foregoing computations of debt/equity ratio for the reason given in paragraph 3.17. If guarantees were to be included, the debt/equity ratio would become 11.7:1.

Audit

4.08 KDB's accounts are audited by its Government appointed internal auditor who is a permanent member of KDB's Board of Directors, but having no vote. KDB engaged the services of Arthur Young & Company (AY) of the United States to audit KDB's accounts for 1973. While preparing audited accounts for 1973, AY also prepared for comparison purposes audited accounts for 1972. AY has given an unqualified report for both years. KDB has no

objection to having its accounts audited by independent qualified external auditors satisfactory to the Bank. AY has already been appointed to audit the accounts for 1974.

Evaluation of KDB's Portfolio

4.09 Loan portfolio. On the whole KDB's loan portfolio is sound. An analysis of KDB's clients as of December 31, 1973, showed that of the 452 companies in operation (93% of total clients) 282 companies representing 63% of the loan portfolio had profitable operations in each of the past three years, 52 companies (4.3% of the loan amount) had two profitable years in the past three, while 80 companies (12.2% of the loan amount) had profitable operations in at least one of the three years. Only 38 companies (8% of total by amount) had losses in each of the past three years. The default rate has been low and has declined further in the recent past. Total arrears of principal and interest stood at W 18.4 billion (5.5% of total loan portfolio) as of December 31, 1973, and have declined to W 17.1 billion ^{1/} (4.6% of total loan portfolio) as of June 30, 1974. The percentage of the portfolio affected by defaults also declined from 7.6% to 4.8% during the same period. Since January 1, 1971 there has been a noticeable improvement in KDB's loan collections as indicated by the improvement in total collections as a percentage of total amount due in that year from 72.5% in 1971 to 91.3%, 94.6% and 97.2% in 1972, 1973 and 1974 (to June 30) respectively.

4.10 In terms of the provisions of its Operating Manual and the "Policy Statement" KDB is required to obtain at least 125% collateral against its loans and 120% collateral against its guarantees. However, there is no collateral requirement for loans to and guarantees made on behalf of Government and KDB owned and/or controlled enterprises and public bodies. As at December 31, 1973 total loan and guarantee assistance given to KDB and Government-owned and/or controlled enterprises and public bodies had amounted to W 672.6 billion (loans W 237.6 billion and guarantees W 435.0 billion). The value of collateral held by KDB against the remaining loans (W 80.9 billion) and guarantees (W 352.4 billion) was W 523.4 billion or 121% of KDB's outstanding assistance. The collateral values are conservatively appraised, and when the Guarantee Release Arrangement (paragraph 3.17) becomes effective, the collateral coverage for KDB loans would become very satisfactory.

4.11 Equity investment portfolio. While evaluating KDB's equity investment portfolio, it should be kept in mind that KDB makes equity investments either to promote a project considered vital for the national economy or to acquire sufficient control over a client in difficulties to be able to improve its management and thereby its operating results; KDB does not make equity investments purely for profit making purposes. Against that background the performance of KDB's investment portfolio has been satisfactory. Total yield on investment has improved from an average of 2% during 1969 to 1972 to 5.4% in 1973 and 7.5% in 1974. The capital gains reported as realized are, at least notionally, inflated as in the past KDB

^{1/} Including the amounts transferred to Readjustment Corporation.

sold some of its investments on a deferred payment basis with the interest charged on the deferred amount invariably lower than the prevalent interest rate affecting KDB's income in future years. Such sales have, however, become less frequent in recent years and the amounts involved have also become much smaller. For example, in 1971 total notional loss (spread over 12 years period) was W 1.6 billion compared to W 479 million for 1972 and W 405 million for 1973. There were three sale transactions in 1974, all for cash payment. The performance of companies in which KDB had invested has considerably improved during the last two years; KDB is unlikely in future to have to resort to sale on concessional financing terms.

4.12 Investment in KECO. KECO is Korea's national electricity generating and distribution company and has an almost monopolistic position. As at June 30, 1974 KDB's total investment (excluding guarantees) in KECO amounted to W 134.5 billion (loans W 132.7 billion and equity investment W 1.8 billion) which accounted for 37% of KDB's total outstanding loan portfolio and 2.9% of its total equity investment portfolio. Moreover, most loans to KECO were made by KDB at the behest of the Government. In order to safeguard KDB against the risks of excessive exposure, an arrangement satisfactory to the Bank has been worked out between KDB and the Government whereby, in effect, the risks involved have been taken over by the Government.

V. PROSPECTS

General Outlook

5.01 Because of its export oriented development strategy, the health of Korea's economy depends heavily on world-wide economic conditions. The slow down in the economies of Korea's major export markets, USA and especially Japan, has already affected Korea's economic growth. At this time the Government has not changed its long term outlook significantly although the short-term macro economic framework is being reviewed. The basic development strategy of reliance on the export oriented manufacturing sector is being maintained.

5.02 The Government's industrial strategy aims especially to deepen the industrial structure by promoting heavy and chemical industries, a move which started in the late sixties and has gained considerable momentum since then. Side by side with heavy industries such as steel, shipbuilding and chemicals, light industries are also given a significant role; they are expected to contribute substantially to the achievement of export targets. In view of the developments of 1974 and resultant prospects of slower growth in exports than in the past, particular emphasis is now to be placed on increasing the domestic value added in exports. In terms of total output, heavy and chemical industries are to increase their share from 35% in 1972 to 51% in 1981; of the total estimated investment during 1973-1981, such industries are expected to account for about two-thirds. The vast amounts

(about \$12.5 billion over the period) that will be necessary to achieve the ambitious growth are to be financed increasingly by domestic savings, though it is likely that dependence on external resources will continue to be substantial. The financial sector of the economy will be under challenge to organize the mobilization and allocation of those funds. KDB, because of its large size, its competent management and staff and its development oriented policies, will play an important role in Korea's continued development. Its own operational strategy is likely closely to follow the overall national industrial strategy.

Business Forecasts

5.03 KDB's operational forecasts for the period 1975-79 are given in Annex 18. Forecast commitments are as follows (billion Won):

	Domestic Currency Loans	Foreign Currency Loans	Total Loans	Investments	Total Commitments
1974 (actual)	128.95	24.25	153.20	12.36	165.56
1975	136.03	32.70	168.73	9.58	178.31
1976	151.80	39.84	191.64	15.77	207.41
1977	162.45	33.52	195.97	17.92	213.89
1978	173.78	41.75	215.53	19.92	235.45
1979	185.93	42.10	228.03	21.92	249.95

5.04 Commitments for 1975 are based on KDB's Operational Program for the year (paragraph 2.17), applications in hand for financial assistance and those expected to be received. From 1976 onwards domestic currency loans have been projected assuming a 7% growth rate. The projected volume of operations is constrained by resource expectations rather than by expected lack of demand for KDB assistance. Considering the Government's growth targets and estimates of overall investment demand, KDB's business forecasts are probably too conservative and should be attained unless there is an unexpected setback in the Government's or KDB's efforts to raise resources.

5.05 The share of foreign currency loans in the total mix of loans increased from 10% in 1973 to 15.8% in 1974 and is projected to increase to 19.4% in 1975. This reflects the perception of a change only in the pattern of financing of imports rather than a change in the nature and composition of projects to be financed. In the past, on an average, 27% of KDB's domestic currency loans were used for the procurement of imported equipment and machinery. (Foreign exchange is made available for authorized imports by the Korean Government against equivalent payment in domestic currency.) In view of the large demand for its domestic currency funds, KDB proposes to use foreign currency loans to an increasing extent to finance the import needs of its sub-projects.

Resource Needs

5.06 KDB makes use of some of its foreign currency resources for financing domestic operations, and as stated in the previous paragraph, a part of its domestic currency loans is in fact used by the borrowers for financing imports. KDB's resource requirements for the future should therefore be reviewed in aggregate terms (domestic and foreign resources together). Since demand for domestic currency funds is expected to be larger than the availability of funds from domestic sources, KDB intends to use only its borrowings from such international institutions as KfW, ADB and the Bank for financing foreign currency loans; funds to be raised through borrowings from foreign commercial banks and issuance of IFDs in foreign currency would be converted to augment the domestic currency resources of KDB. During the two years ending December 31, 1976, KDB's total additional commitments (loans and investments) are projected at about W 385.7 billion. Including an investment of about W 35 billion to maintain satisfactory liquidity (actual investment in liquid assets as of December 31, 1974 was W 31 billion), KDB's total resource needs to the end of 1976 total W 420.7 billion. During 1975 and 1976 KDB plans to raise total resources of W 378.4 billion as follows (billion Won):

Sources of Funds

Increase in paid-in capital	11.5
Borrowings from	
Government	59.8
NIF	122.2
IRF	11.5
Foreign commercial banks	
(\$80 million)	38.8 /a
Issuance of IFD (net)	66.0 /b
KfW (DM 15 million)	3.0 /a
ADB (US\$67 million)	32.5 /a
IBRD (US\$60 million)	29.1 /a
Total	<u>374.4</u>

/a In foreign currencies.

/b Partly issued in foreign currency.

5.07 To the above new resources should be added the uncommitted balance (W 45.2 billion) of resources available as of December 31, 1974 which would give a total of W 419.6 billion - almost equal to the net requirement of the period. The proposed Bank loan of W 29.1 billion (\$60 million equivalent) would enable KDB to complete its financing plan for 1975 and 1976. A schedule of projected disbursement from the proposed Bank loan is given in Annex 23.

Financial Projections

5.08 KDB's projected balance sheets as at December 31, 1975 through 1979 are given in Annex 19. In the next five years ending December 31, 1979 total assets are projected to increase at the rate of about 28% p.a. which is slower than the actual growth rate in the recent past (see paragraph 4.06). A relatively smaller base helped KDB achieve a high growth rate in the past. In the next five years, total loan portfolio (net of provision for doubtful accounts) is projected to increase by more than two and a half times from W 425.7 billion as at December 31, 1974 to W 1,112.0 billion as of December 31, 1979. Investments, however, are projected to increase by only about 52% since KDB plans to roll over its investments. Total new investments during 1975-79 are projected at W 85.1 billion while sales are planned at W 45.2 billion. The primary objectives of this heavy roll over of investments are (a) to reduce KDB's investment in companies in which its present holding is more than 50% and (b) to broaden the base of industrial ownership in Korea. Total portfolio (loans plus investments) is projected to increase by 145% during 1975-79 period. Reserves and provisions are estimated to increase as a percentage of total portfolio from 4.6% at the end of 1974 to 6.4% at the end of 1979. Total debt to equity ratio will improve from 12.3:1 in 1974 (all guarantees included in debt) to 4.8:1 in 1979 (all guarantees covered by the Guarantee Release Arrangement excluded from debt). KDB's long-term debt/equity ratio is likewise projected to improve from 11.7:1 in 1974 to 3.5:1 in 1975 though rising gradually thereafter to 4.5:1 in 1979. These ratio take into account the expected increase in KDB's equity by at least W 85 billion later this year.

5.09 KDB's projected income statements through 1979 are given in Annex 20. Based on the projected business operations, net income is expected to increase from W 4.1 billion in 1974 to W 10.5 billion in 1979. Consistent with its usual accounting practice, KDB has made projections of income on an actual receipt basis and of expenses on an accrual basis, causing projected income to be somewhat understated. Interest income is expected to contribute 84% of gross income in 1979 (78.5% in 1974). A relatively high share of equity funds in KDB's total capitalization assures profitable operations, despite negative or no margin on lending from borrowed funds. KDB's actual experience in 1974 supports this expectation (paragraph 4.04). Net income as a percentage of equity is projected first to increase from 2.9 in 1974 to 4.7 in 1976 and then to fall slightly to 3.3 in 1979. Considering KDB's role in the Korean economy and the fact that it is 100% owned by the Government, which does not expect any direct return on its investment in KDB, the estimated returns on equity are reasonable.

5.10 KDB's projected cash flows are shown in Annex 21. The debt service cover in future years is apparently thin for two reasons. First, the deposits received by KDB in foreign currency which amounted to W 34.4 billion as of December 31, 1974 are projected to be substantially (90%) repaid before the

end of 1976 resulting in a heavy debt servicing burden during this period, ^{1/} and are therefore included in the calculation of debt service coverage. Secondly, KDB's liability to redeem IFDs is large (on an average W 27.5 billion p.a.). A significant part of KDB's resources is raised in the form of IFDs which are of relatively short duration (average 2 years) but the funds are used for financing both the short-term working capital loans as well as long-term equipment loans. Heavy recurring repayments of IFDs would not create any debt servicing problem as these would be refinanced through issuance of new IFDs, which exceed yearly redemptions (average new issuance of IFDs is projected at W 56.4 billion p.a.). Moreover, KDB has taken a policy decision, with the knowledge of the Government, to issue more of long-term debentures in foreign capital markets, rather than short-term debentures in the domestic market. The Government has also agreed to guarantee KDB's debentures issued in the foreign capital markets. If the amount of IFDs refinanced annually are excluded, the debt service cover improves to a minimum of 1.2 times in all the projected years.

Proposed Bank Loan

5.11 As stated in paragraph 5.07, a Bank loan in the amount of US\$60 million is recommended to meet a part of KDB's capital requirements to the end of 1976. The proposed loan will account for considerably less than 10% of KDB's resource needs for the years 1975 and 1976.

5.12 The Bank could hope to achieve two main objectives through lending to KDB: (a) financing of industrial development and influencing the course of policies affecting such development, and (b) having a constructive influence on KDB as an institution, the Bank's traditional role of institution building. As regards the first objective, the Bank has recognized that manufacturing is expected to remain the principal engine of economic growth and employment in Korea, and has concluded that the Bank Group could support the development of the industrial sector most effectively through the development finance companies. The Bank has been lending to KDFC since 1968; with the proposed loan to KDB and another proposed loan to MIB in FY 76, the Bank will cover the entire specialized field of long-term industrial lending in Korea. As to the Bank's institution building role, KDB's management strongly wishes to establish a relationship with the Bank and is receptive to new ideas. In fact the Bank has already had significant impact on KDB's policies (a major revision of the Policy Statement) and financial position (Guarantee Release Arrangement and the arrangement in respect of its loans to KECO). KDB's appraisal techniques are also expected to improve in the future (introduction of the economic rate of return analysis). Indirectly, the Bank loan may also help KDB in its resource raising efforts in the international capital markets.

^{1/} These deposits were made by KEB, which now intends to withdraw them as KDB has started to raise foreign currency funds independently from the international money market.

5.13 The proceeds of the proposed loan will be used to finance direct imports. KDB has given the Bank to understand (agreed minutes of the negotiation) that (i) the loan proceeds will be used principally to finance projects in the manufacturing sector although such other sectors as shipping, mining, service industries will also be eligible, (ii) it intends to finance projects mainly in the private sector although public sector projects will also be eligible, (iii) in selecting projects, KDB will abide by the Government's overall economic policies and priorities and will give preference to export oriented projects, heavy and chemical industries, import substitution industries and to intermediate goods producing and employment creating projects, and (iv) it will not limit the use of the proposed Bank loan to a few very large projects (individual sub-loan amounts will not normally exceed US\$4 million each).

5.14 KDB's capital structure is sound, and given its sound portfolio, and the competence of its management and staff, a debt/equity ratio limit of 5:1 is recommended with "debt" defined to cover all borrowings having a maturity of more than one year (including Government loans) and those guarantees which will not be covered by the Guarantee Release Arrangement. An initial free limit of \$750,000 is recommended; with it, the Bank could expect to receive projects requiring prior approval aggregating about 70% of the proposed loan by amount. However, since this would be the Bank's first loan to KDB, an aggregate free limit of US\$18 million (30% of the proposed loan amount) is also recommended as a safeguard. The minimum interest rate on subloans charged by KDB would be 2% above the Bank's lending rate, with the exchange risk borne by the sub-borrower. Other terms and conditions of the proposed loan will be similar to those in recent Bank loan agreements with DFCs, including a flexible amortization schedule.

KOREA DEVELOPMENT BANKEconomic, Industrial and Financial EnvironmentEconomic Overview

1. For a detailed review of the recent economic situation and prospects, reference is invited to the Bank's latest economic report on Korea: Current Economic Position and Prospects of the Republic of Korea (In Two Volumes), February 20, 1974, 332-KO. An Economic Mission returned in February 1975 after completing the field work in Korea; its report is under preparation.

2. In recent years, Korea's economy has shown an impressive performance with its per capita income doubling over the last 10 years (1973: US\$310) and its GNP growing at 11% p.a. since 1968. The stimulus for the rapid growth was provided by an even faster growth in the manufacturing sector which in 1973 contributed 28% to GNP. The manufacturing sector is now the largest sector, since the share of agriculture decreased from 28% in 1968 to about 23% of GNP in 1973 although the annual growth rate of agriculture, too, has been satisfactory at 3.5% p.a. Between 1968 and 1973 investment expenditure increased by 12% p.a. The single most important factor responsible for Korea's economic growth has been the remarkable export performance; exports increased by 34% p.a. in constant terms and their contribution to GNP increased from 13% in 1968 to 28% in 1973.

3. In 1973 the Korean economy surpassed its already good performance in the past: GNP grew by 16.5%, manufacturing output by 31%, exports by 61%, and gross domestic investment by 46%. This pace of the economy was unsustainable and strains on the economy were already developing, including scarcities of raw materials, shortages of operating funds and inflationary pressures (see para 23), when the energy crisis and the recessions in Korea's major export markets (Japan and the USA) hit the economy. During the first half of 1974, investment remained at relatively high levels, industrial output and exports continued to increase and GNP grew at an annual rate of about 14%. The full impact of the world wide economic slow down was felt in the second half of 1974 as exports dropped sharply, pulling down the rate of growth of exports for the whole year to about 7.8% only, compared with 61% in 1973. This led to sharp cut backs in industrial output and fixed investment, especially in export industries, while further increasing the build up in inventories. Imports, on the other hand, which had started earlier as a result of domestic demand contraction grew much faster than exports, thereby considerably weakening Korea's balance of payments position. Due to its heavy dependence on exports, an acceleration in the growth of Korea's economy is inevitably linked to a recovery in the economies of Korea's major export markets.

4. The rapid growth of the last few years required large amounts of investment funds, and considering Korea's rather limited resource base, led to substantial external borrowings which tripled between 1968 and 1973, although the domestic savings performance by itself was quite remarkable averaging 17% of GNP between 1968 and 1973 (compared with 11% in the preceding five years). The debt service burden, temporarily at 20% in 1971, however, came down to 10% in 1973 thanks to the excellent export performance.

The Industrial Sector

5. Recent developments. Over the last six years, manufacturing was the fastest growing sector in Korea's economy with an annual growth rate of 20%. Its share in GDP increased from 20% in 1968 to 28% in 1973 and during the same period it accounted for 42% of the growth of GNP. Investments in manufacturing remained stable in constant terms between 1968 and 1972 but in 1973 jumped by 85% to US\$700 million equivalent, accounting for 26% of total fixed capital formation in 1973 and for 7% of GNP. In 1974 fixed investment in manufacturing increased in nominal terms to about US\$730 million but dropped in real terms by nearly 18% and its share in total fixed capital formation dropped to 18%. A feature of the development of manufacturing industries is the fact that between 1968 and 1972 the average capital output ratio was a low 1.4 despite the investments in such large capital intensive projects as Korea's first steel plant and a naphta cracking plant. It was the result of balanced growth with substantial investment in such labor intensive sub-sectors as textiles, wearing apparel, leather and electronics also taking place simultaneously.

6. The rapid expansion of manufacturing output was based mainly on an even faster growth of manufactured exports; these increased at a rate of about 50% p.a. over the last five years. Exports of manufactures amounted to more than \$4.0 billion and accounted for about 90% of total exports in 1974 (1968: 74%) and about 30% of total manufacturing output in that year (1968: 11%). The two largest markets for Korean exports of manufactures are the USA and Japan, which together account for almost 75% of total exports. The risks of high market concentration were demonstrated during 1974; Korea's Government is now making vigorous efforts to diversify exports to other markets, including Africa, Middle East and South America.

7. Statistics for the first 10 months of 1974 show that growth in manufacturing output slowed considerably after the middle of the year, especially in Korea's traditional export sectors like textiles, wearing apparel and wood products processing industries. This is a reflection of the drastic drop in total exports which, in real terms, in the last quarter of 1974, were even below the corresponding levels of 1973. Since real domestic consumption demand also declined due to substantial price increases

and fixed investment was down (for instance, building construction permits in the second half of 1974 were about 50% down from levels reached in the same period of 1973), producers' inventories increased by almost 60% during 1974.

8. Structure of industry. Measured in terms of value added in 1973, light manufactures accounted for almost two thirds of total industrial value added. The growth performance of the sub-sectors varied but was very good throughout as the following table shows (amounts in billion Won):

	1968		1973		Growth Rate (% p.a.)
	Value Added ^{/a}	%	Value Added ^{/a}	%	
<u>Light Manufactures</u>					
Food, beverage, tobacco	68.7	22.8	160.8	20.6	18.5
Textile, footwear, leather	59.9	19.9	166.8	21.4	22.7
Wood, furniture, paper, printing	32.6	10.8	63.4	8.1	14.2
Rubber, clay, glass, stone products	25.3	8.4	58.3	7.5	18.2
Electrical equipment ^{/b} , plastics	5.8	1.9	53.3	6.8	55.2
	<u>192.3</u>	<u>63.8</u>	<u>502.6</u>	<u>64.4</u>	<u>21.2</u>
<u>Heavy manufactures</u>					
Chemicals, petroleum and coal	55.5	18.4	122.5	15.7	17.2
Basic metal, metal products ^{/c}	18.8	6.2	51.5	6.6	22.4
Machinery (incl. electrical ^{/c})	13.5	4.5	30.3	3.9	17.5
Transport equipment	14.6	4.9	55.0	7.0	30.2
	<u>102.4</u>	<u>34.0</u>	<u>259.3</u>	<u>33.2</u>	<u>20.5</u>
<u>Other</u>	<u>6.7</u>	<u>2.2</u>	<u>19.1</u>	<u>2.4</u>	<u>23.3</u>
Total	<u>301.4</u>	<u>100.0</u>	<u>781.0</u>	<u>100.0</u>	<u>21.0</u>

^{/a} at 1968 constant prices (GNP deflator for the manufacturing sector: 9.3% p.a.).

^{/b} includes manufacture of radio, television and communication equipment and apparatus and manufacture of electrical appliances and housewares.

^{/c} excluding industries listed in footnote ^{/b}.

Source: Report on Mining and Manufacturing Survey, EPB and KDB; and Monthly Economic Statistics, BOK.

Textiles, footwear and leather is the largest sub-sector accounting for slightly more than one fifth of total industrial output in 1973. The impetus for growth of this sub-sector was provided by export sales. In 1968, exports

accounted for 28% of total output of this sector; by 1973 this percentage had increased to 64%. Over the last five years there has been no significant shift from light to heavy manufactures though between 1972 and 1973 heavy manufactures increased its share in total value added from 29.8% to 33.2%. With the recent government emphasis on promoting heavy and chemical industries (see paragraph 13) envisaging total fixed investments in heavy manufactures of about \$6.9 billion equivalent by 1981, the share of this sector is expected to increase to about 45% by 1981.

9. Of a total of 23,729 industrial enterprises in Korea in 1972, 1/ 96.5% employed less than 200 workers each. However, in terms of employment and value added, such enterprises accounted for only 45% and 28% of the total, respectively. Despite adequate promotional policies and availability of industrial finance, the relative importance of small- and medium-sized enterprises in the total industrial structure has been declining. In 1972 large enterprises accounted for 78% of total fixed investment while it was only 69% in 1968. Large enterprises' share in total value added (from 64 to 72%) and total employment (from 46 to 55%) has also increased since 1968. This trend will most likely continue since the Government's long-term policies aim at deepening the industrial structure by establishing heavy and chemical industries with optimum capacities (see paragraph 11).

10. Geographically, industrial enterprises are concentrated in Seoul and Bussan provinces where 50% of all enterprises are located, accounting for 71%, 74% and 63% of total employment, value added and new gross fixed investment respectively in 1972. Industrial employment in these two provinces accounted for 85% of the additional 225,000 jobs created in Korea's industrial sector between 1968 and 1972. However, the Government is placing increasing emphasis on a wider geographic distribution, has supported the establishment of growth centers in other provinces, and as a result greater industrial dispersion can be expected over a period of time.

11. The financing pattern of industrial enterprises has considerably improved in recent years. In 1971, return on total capitalization of all industrial enterprises was a low 0.5% and enterprises were in general undercapitalized showing an average debt equity ratio of 4.2. The debt/equity ratio improved considerably by 1973 (2.6) mainly because of significantly higher profitability (6.9%). The improvement in profits in 1972 and 1973 was a result of many factors such as continuing brisk demand, a lag in wage increases behind productivity increases, continuing improvement in capacity utilization and also the August 3, 1972 measures, that, among others, substituted high cost short-term debts by low cost long-term debt. In 1974, however, companies again came under considerable financial strain as demand slackened, inventories piled up and costs continued to rise. In 1973, of the total industrial investment for fixed assets amounting to about \$700 million equivalent, about 40% was in equity funds and the balance

1/ Figures in this and the next paragraph are based on the manufacturing census, 1972. The census does not define "small", medium and "large" enterprises but the MIB Act defines "large" enterprises as those employing 200 workers or more (see paragraph 18).

in borrowed funds. Of the equity funds, about 60% was in the form of retained earnings and the balance in the form of new share capital, divided about equally between domestic and direct foreign investment. Of the total debt capital, external sources accounted for about 35%.

12. Industrial strategy. The economic slump that developed in 1974 prompted the Government to take a series of short-term measures to ease the burden for a number of industries that faced serious liquidity problems. The generally tight financial policies in effect in the first half of the year were relaxed, credits for imported and domestic industrial raw materials were increased, and programs to purchase excess inventories and to make available special credits to small businesses were begun or expanded. The devaluation of the Won by 17.5% in December 1974 is also expected to help export oriented manufacturing enterprises. To stimulate private investment, the Government has increased public sector outlays over originally planned levels.

13. The Government's long term industrial strategy has been based on vigorous promotion of the export sector. The strategy has proved highly successful and has resulted in remarkable progress of the economy as a whole. As a logical evolution of this strategy, emphasis shifted in the late sixties and early seventies to strengthening and deepening the industrial structure by promoting heavy and chemical industries. In view of the developments of 1974 and resultant prospects of slower growth in exports than in the past, particular emphasis is now to be placed on increasing the domestic value added in exports. The investment requirements will be large and therefore a major effort has been launched to increase domestic savings. The vehicle for vastly increased domestic savings is going to be the National Investment Fund (NIF) which was set up when the NIF Law was promulgated on December 14, 1973. The Minister of Finance is in charge of the Fund but in effect delegates its management and operation to the Governor of the Bank of Korea. Before the present economic down turn developed, the NIF was estimated to account, by 1981, for about 75% of total investment needs of major industries, amounting to W 6,100 billion (US\$12,600 million). The resources of the Fund will be mobilized mainly (about three-fourth) by issuance of NIF--Bonds and the remainder by direct subscription by the Government. NIF-Bonds will be bought by various savings institutions including banks and insurance companies and by private investors. The funds will be on-lent through the banking system for investments in fixed assets (about two-thirds) and for working capital needs of major industries. Banks will be charged 10.5% p.a. and allowed a spread of 1.5% so that borrowers will pay 12% p.a.

14. In order to promote industrial development in general and to direct industrial investment to particular sectors, the Government provides various incentives, the package of which includes reductions in corporate, business and income tax rates, easy access to credit, preferential interest rates, depreciation and other allowances and protection

through tariffs. Incentives are also extended to attract foreign investment, encourage public ownership of closely held companies and to promote decentralization of industries. Besides these incentives, a number of other measures aim solely at the small-medium scale industrial sector. A summary of incentives for various industrial sectors is given in Annex 1A. Incentives for exports of manufactures are estimated to amount to about W 87 per Dollar of exports in 1970 with an estimated effective rate of subsidy of 9-12% on total exports of manufactures. As for tariffs, a recent study ^{1/} suggests that effective protection in domestic manufacturing sales was negative in 1968. Since 1968 the tariff structure has not changed substantially and, therefore, it can be assumed that effective protection has continued to be negative or, at the most, very low. Total receipts from custom duties as a percentage of total imports amounted to a low 4.7% in 1973.

Financial Environment

15. Institutional arrangement. The financial sector of Korea consists of the Bank of Korea, Deposit Money Banks and non-monetary financial institutions (see paragraph 15). The Bank of Korea performs regular central banking functions, including the supervision of commercial banks. Deposit Money Banks are either commercial banks or specialized banks. Commercial banks are characterized by receiving their funds mainly through deposits from the public. They can make all kinds of loans; however, they have traditionally concentrated on short-term lending. Recently they have increased long-term lending business, and roll over of short-term loans is also common. Most commercial banks have their majority shares held by the Government. All commercial banks are subject to control and supervision by the Bank of Korea. Specialized Banks in contrast are directly controlled by the Ministry of Finance. They were all established under a Special Banking Act and only a few specific Articles of the Bank of Korea Act and General Banking Act apply. Specialized Banks, as their names imply, were founded for particular purposes/sectors (such as small-scale industry financing, agricultural financing) and their major source of funds are loans, mostly from the Government.

16. There are 5 nationwide commercial banks, ten banks with localized operations, eight branches of foreign banks and the Korea Trust Bank, which have all together 511 branches/offices around the country (all these fall under the term of commercial banks). Specialized Banks include the Korea Exchange Bank, which in 1967 was established mainly to relieve the Bank of Korea of commercial foreign exchange business, the Medium Industry Bank (see paragraph 18), the Citizens National Bank (mainly for mobilizing small savings and financing household loans), the Korea Housing Bank, the National Agricultural Cooperative Fund (NACF) and the Fisheries Cooperative.

17. Besides the above-mentioned banking institutions (Monetary System) there are several non-monetary financial institutions, namely KDB, trust accounts of commercial banks, six life insurance companies and postal savings system. Other non-banking financial institutions (not covered in Korea's monetary and banking statistics) performing specialized functions are the

^{1/} L. Westphal and K.S. Kim, Industrial Policy and Development in Korea (in draft).

Korean Development Finance Corporation (KDFC) which specializes in providing medium- and long-term capital mainly to industrial and transportation sectors (accounts for about 7% of the banking sector's total equipment loans outstanding to industry), the Korean Investment Corporation (KIC), primarily a broker for the offering and distribution of corporate securities, the Korea Investment and Finance Corporation (KIFC) which provides short-term finance to the private industrial sector (in 1973 its market share in notes discounted outstanding was 24% of the total of W 66 billion) and which also started operating in the capital market (in 1973 KIFC underwrote three corporate debentures of W 950 million), eight other recently established short-term finance corporations and the Korea Capital Corporation, all of which deal in short-term money market instruments. In addition, there were 290 mutual savings and finance companies at the end of 1973 and some 1300 authorized credit unions. KDFC was established in 1968 with active support of the World Bank Group; IFC holds 14.3% of its share capital. KIFC is a subsidiary of KDFC, and IFC was one of its sponsors and holds 20% of its share capital.

18. As of October 31, 1974, total loans outstanding to industry by all banking institutions in Korea amounted to almost W 1,500 billion (\$3.1 billion equivalent), three fourth of which was for operating funds, mainly supplied by commercial banks. The largest supplier of equipment fund loans was KDB which, as of October 31, 1974, had an outstanding portfolio of W 95 billion (about \$200 million) or about 40% of total outstanding medium- and long-term credit by banking institutions to industry as of that date.

19. Financing for small-scale industrial sector. The Medium Industry Bank was founded in 1961 as a Government owned and controlled institution to extend financial and technical assistance to small and medium industries. 1/ Its lending is restricted to companies with fixed assets below W 600 million or those with less than 200 employees. It stops lending to those clients that outgrow these limits. Besides its lending operations, it is involved in export financing, credit guarantee operations, international banking, extension services and research of small-medium industries. As of December 31, 1974 MIB's total resources amounted to W 189 billion including loans from AID, ADB 2/ and KfW. As of the same date, it had total outstanding loans amounting to W 157 billion of which W 59 billion or 38% were term loans. About 92% of total loans are to the manufacturing sector. Small-scale industries can also, and do, obtain funds from commercial banks. 3/

1/ A detailed study on small-scale industry financing is contained in an annex to Financing Small Scale Industry (RPO 277) (in draft).

2/ A new loan of \$30 million has been made by ADB in 1974.

3/ Incentives to the small and medium scale industrial sector are summarized in Annex 1A.

20. Capital Market. The Korea Stock Market which was moribund for many years showed signs of life in 1972. Before then the yields on stocks were unattractive as both commercial banks and the "curb market" paid high interest rates. The market was also thin because closely held companies were reluctant to go public. With the economic boom that got under way from about mid-1972 and with additional measures (see also Annex 1A), the public showed growing interest in the stock market. The curb market was severely checked as a result of August 3, 1972 measures and with decreasing interest rates at commercial banks, yields on stocks became attractive. In addition, the overall investment climate became very favourable after August 1972 and there was a campaign for more stock listings and for companies to go public. The result was a great increase in stock exchange activity in the second half of 1972 and in 1973, as the following table shows (figures are as of the end of each period):

	<u>No. of Listed Companies</u>	<u>No. of Shareholders (in '000)</u>	<u>No. of Listed Stock (in million)</u>	<u>Capital of Listed Stock (W billion)</u>	<u>Market Value of Listed Stock (W billion)</u>
1970	48	76.3	159.0	134.3	97.9
1971	50	81.9	170.2	141.4	108.7
1972	66	103.3	209.8	174.3	245.9
1973	104	234.9	305.1	251.6	426.2
1974 (May)	112	187.9	383.7	312.9	465.3

21. The capital market continued to grow and strengthen during the first half of 1974 as a result of favourable Government policies. However, the stock prices have dropped in recent months after record highs in 1973, following the economic slow down and unfavourable international developments. The number of shareholders fell considerably, mainly because of withdrawal of small investors. Over the years the ownership structure has broadened, though at December 31, 1973, two thirds of all shareholders still held less than 100 shares each, accounting for only 1% of all shares outstanding, while less than 1% of all shareholders owned about 70%. The importance of the Government as a shareholder of industrial companies also decreased. While in 1970, the Government (including public bodies) held about 39% of all listed stocks, its holding declined to 20% of the total by the end of 1973. Also, the proportion held by banking institutions decreased from 15% to 8%.

Interest Rates, Inflation

22. Interest rates in Korea are controlled by the Government through the Monetary Board and apply to all banking institutions. Specialized financial institutions such as KDFC or the short-term finance companies are not legally bound; however, in practice they, too, have to follow government policies. At present, deposit rates range between 1% p.a. (for demand deposits), and 15% p.a. (time deposits). Although not directly comparable,

it may be mentioned that public debentures yield about 21% p.a. and the average dividend yield on common stock was 13.6% as of June 30, 1974. General lending rates for loans stand at 15.5% irrespective of duration. ^{1/} Preferential rates are granted for various sectors or types of loans such as loans for exports (9%), equipment loans for machine industry production (10%), loans for equipment to export industries (12%) and loans made from proceeds of the National Investment Fund (at 12%). Rates in the curb market, which has reportedly become alive again could be as high as 35% p.a. Rates on foreign exchange loans made by KDB, MIB and KDFC are usually at 9-10.5% with the exchange risk borne by the borrower.

23. The development of Korea's interest rate structure has, since about 1968, seen a continuous reduction in both deposit and lending rates. In prescribing preferential rates for various industrial sectors, the Government's financial aims were to strengthen the competitive position of Korea's export industries and to give all possible support to those industries that figure heavily in its long range development plans. The lowering of the rates coincided, in general, with the Government's gradual success in bringing inflation down until late 1973 when the inflation rate jumped up again. ^{2/} With the emergence of the oil crisis and the general world-wide inflation, Korea's price structure was particularly hard-hit because of its high foreign trade dependence. Between November 1973 and April 1974 wholesale prices shot up by 36%. Since then domestic inflation has slowed somewhat reflecting seasonal factors, slower increase in prices for imported goods and the dampening effect of demand contraction and rising inventories. For the whole year of 1974, wholesale prices rose by 44.6%. In view of the overall weakness of the economy and its expectation to succeed in bringing inflation under control, the Government has not changed the interest rate structure significantly. However, on December 9, 1974, preferential rates for loans from the NIF and the Industrial Rationalization Fund were increased from 9% and 8% respectively to 12% for both, and the rates on time deposits for over three months (12%) and over six months (13.2%) were temporarily^{3/} raised to 15%.

24. KDB's interest rates. KDB's interest rate structure is complex due to its many sources of funds and is further complicated by a number of priority industries that the Government subsidizes with lower interest rates (see Annex 1A). The rates at present range from 7.5% for Special Fund Loans to 15.5% for loans made from its general operating funds and 14% or 15% (plus exchange risk) for foreign revolving loan funds. Loans at the lower

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- ^{1/} The lowering of medium-term rates to the level of short-term loans in 1973 was to encourage equipment investment.
- ^{2/} Inflation rates between May 1972 and November 1973, when the impact of the oil crisis could first be felt, grew at only 7.1% p.a. (June 1972 - July 1973: 8.9% p.a.).
- ^{3/} Applicable to deposits received from December 9, 1974 to June 30, 1975.

end of the scale are extended for projects that are selected by the Government as priority projects or fall within the framework of general government policy (such as loans to heavy and chemical industry). Loans at 15% or 15.5% are mostly for working capital loans (only 1.6% of all equipment fund loans in KDB's portfolio pay 15% or more). Loans funded from foreign loans carry interest rates from 9% (KfW) to 10% (AID); the exchange risk, however, is borne by the customer. Also loans made from revolving funds (at 14% p.a. for equipment fund or 15% p.a. for working capital loans) carry the foreign exchange risk via a value maintenance clause. Borrowers of funds from the recent \$80 million loan from an international banking consortium are charged the Euro-Dollar rate plus 1% margin and the borrowers also assume the exchange risk whether the loan is made in foreign currencies or in Won (in the latter case, via a maintenance of value clause). A complete list of interest rates charged by KDB and prevalent in the country is given in Annexes 1B and 1C.

EAP Projects Department
February 26, 1975

KOREA DEVELOPMENT BANKGovernment Incentives to Industry

1. In Korea's industrial development, Government incentives have played an important role. These incentives are provided in many ways among which the most important are tax concessions, exemptions from import duties, easy access to credit, preferential interest rates, liberal depreciation and other allowances, protection through tariffs and establishment of industrial estates, and more generally provision of dependable infrastructure. Below is presented a summary of incentives that are given to industrial enterprises for various purposes.

2. Export industries. Since about 1964, Government has increasingly encouraged the establishment of export industries though in the recent past the subsidies have been reduced. Major forms of incentives are:

- tax concessions: full exemption from business and commodity taxes; exemption from real property acquisition tax, registration tax and property tax on real estate located in the Export Industrial Estates; special depreciation allowance for business assets used for manufacturing export goods; granting of allowances for overseas market development and for export loss (1% of foreign exchange earnings each), granting of reserve for overseas investment loss (10% of investment amount);
- reduction or exemption from import duties: full exemption of import duties on imports of raw materials to be used in export industries or industries that supply export industries; import duties on machinery for export industries may be paid in installments over three years (before January 14, 1974, these imports were exempt from duty);
- preferential interest rates: loans for equipment of export industries: 12% p.a.; loans for exports: 9% p.a. (before January 24, 1974: 7%);
- easy access to credit: automatic availability of loans for financing the production of export goods;
- preferential access for successful exporters to imports financed with long term trade credits;
- lower requirements on advance import deposits for raw materials for stockpiling and on a D/A or D/P basis used in export production;

- in certain instances, automatic access to banned imports when used for export production; easier access to restricted imports for general use for those with good export performance;
 - wastage allowances on imported materials for export processing that are often highly liberal;
3. Key industries. 1/ -- tax concessions: exemption from commodity tax, electricity and gas tax, granting of 6% of investment credit, granting of special depreciation (20% generally for equipment used in mining and manufacturing and 60-80% for 59 qualified industries);
- reduction or exemption from import duties for buildings, machinery and their parts to be used in Key industries (this tariff privilege will be phased out by 1980);
 - preferential interest rates: loans for machine industry promotion: 10% (equipment loans) and 12% (working capital loans); for major industries: 10% (equipment loans); NIF loans: 9%.
 - easy access to credit.
4. Direct foreign investment. Under the Foreign Capital Inducement Law of 1966, the Government offers generous incentives for direct foreign equity investment. Direct foreign investment has to be approved by the Ministry of Economic Planning Board and is usually restricted to 50% of total capital though majority foreign shareholding is possible 2/ if (a) production is entirely for export in industrial lines in which such investment is generally allowed in other countries and (b) in industries which are relatively new in Korea and which would otherwise involve considerable time to find a Korean partner; in this case, however, stocks have to be gradually transferred to Korean nationals (up to 30% within first three years and up to 50% within first five years). Foreign investment cannot exceed 50% in purely labor intensive industries, bonded processing industries or industries using important raw materials produced in Korea.
-
- 1/ ship building, iron and steel, fertilizer, power generation, chemical fibre, automobile parts, machine industry, chemical pulp, mining, marine and agricultural products processing, national land development and construction projects, petrochemical industries, electronics, business utilizing a result of a technical innovation, exploration of natural resources in sea bed and sub-soil.
- 2/ At December 31, 1972, 41% of all foreign invested enterprises had foreign majority ownership.

5. Direct investment has increasingly been directed to export industries and in 1973 close to 95% of all approved projects were for total export production (1971: 55%). The following incentives are granted to foreign equity investors:

- tax concessions: exemption for five years in proportion to the ratio of stocks owned by the foreign investors and 50% reduction for the following three years from corporation tax, income tax on unincorporated enterprises, dividend income, tax on technology income, property tax and property acquisition tax. Full exemption is also granted for wages and salary income tax on foreign employees;
- guarantee for remittance of dividend and repatriation: unlimited remittance of profit dividends is guaranteed after two years from start of business;
- reinvestment of profits is permitted under law up to original investment; amount exceeding that limit has to be approved by EPB;
- property guarantee against requisition or expropriation: The same rights, privileges and protection enjoyed by Korean nationals are extended to foreign individuals or enterprises.

6. Wider geographical distribution of industries. The Government has encouraged the decentralization of industries under the Export Industries Compound Law, Rural Industrial Development Law and the Law for the Establishment of Free Export Zones. Under these Laws, the Ministry of Construction, Local Government and the Free Export Zones Authorities have established Export Industries Estates, other Industrial Estates and two Free Export Zones (Masan and Iri, the latter one to be completed by the end of 1974). Export Industries Estates, mostly for medium-sized firms, offer services to manufacturing companies that have export prospects of above US\$250,000/year, with high ratios of foreign exchange earnings, advanced manufacturing techniques and labor intensive production methods. All relevant incentives listed in para 2 (Export industries) apply to Export Industries Estates or Free export Zones. In addition the following incentives are granted:

- tax incentives: for Local Industrial Estates exemption from corporation tax for first five years and reduction to 50% for ensuing three years; depreciation allowance of 20%; exemption from property tax, acquisition tax and registration tax; companies that move from large cities to rural areas other than industrial estates receive a reduction of 6% of corporate income tax for the first year;

- supporting and related facilities such as transportation, packing, road network, repair and maintenance of machines and tools, power and water; in some cases provision of port facilities; possibility of leasing plant buildings; communication systems; banks; customs offices, etc.;
- in Free Export Zones, administrative procedures concerning foreign investment, joint ventures, approval of occupancy and construction of plant are simplified by the Administrator of the Zone; labor disputes occurring within the Zone are mediated under the regulations concerning public utilities in the Labor Dispute Mediation Law for the special protection of the occupant enterprises.

7. Enterprises listed on the Stock Market. Since 1968, the Government has encouraged wider public ownership of companies. At that time the Corporate Income Tax Law was revised giving various incentives to public corporations. Investment in real estate was discouraged at that time with the passing of the Real Estate Speculative Investment Law and with the Capital Market Development Promotion Law, under which the Korean Investment Corporation was established, underwriting of securities was to be promoted and undue fluctuations in stock prices to be prevented. Subsequently, new methods of stock trading were introduced to remove speculative elements in stock transactions. In 1970, the Registration of Public and Corporate Bonds Law was passed to simplify procedures of issuing public and corporate bonds. In the same year measures were introduced to facilitate public sales of stocks by private companies which had received foreign loans with Government repayment guarantees. In 1972, the Government introduced the Public Corporation Inducement Law which aimed at increasing the supply of quality stocks on the Seoul Stock Exchange. As a consequence of this Law the Government has now the authority to designate enterprises which must go public. The recent NIF Law also provides this feature as companies that receive funds from NIF may be designated by the Minister of Finance to go public.

S. Tax incentives to go public include:

- corporate income tax reduction:

<u>Taxable Income (Won)</u>	<u>Publicly Held</u>	<u>Closely Held</u>
1 million or less	16%	20%
1 to 5 million	20%	30%
over 5 million	27%	40%

- publicly held enterprises can carry forward losses for four years;

- publicly held enterprises may make a provision for bad debt up to 2% of total receivables/loans, and an amount which has not been collected may be charged to the loss account;
- depreciation allowance of 20%;
- taxable income and corporation tax may be decided with the submission of relevant documents without any physical investigation of the taxation authorities;
- taxes on dividends to stockholders may be exempted (for stockholders having ownership of less than 3%) or reduced.

9. Small- and Medium-Scale Industries. 1/ Promotion of small- and medium-scale industries 2/ for all practical purposes started in 1961 with the establishment of the Small- and Medium-Scale Industry Division within the Ministry of Commerce and Industry which was made responsible for formulating and coordinating development policies for small- and medium-scale industries. At the same time the Government set up the MIB which it uses to channel funds to the small- and medium-scale industrial sector.. At the end of 1961, the Small and Medium Industry Cooperative Act was passed to promote joint activities of small- and medium-sized industries and thus to help improve their competitive position vis-a-vis large enterprises. In 1964 the Government started to set up industrial estates to foster small industries as export industries and to disperse small and medium enterprises to rural areas. Major incentives for small- and medium-scale industries are:

- preferential interest rates on MIB lending of Government or foreign funds (12% and 8% p.a. respectively);
- easy access to credit: through MIB and commercial banks (they are required to extend at least 30% of their loans to small and medium industries) and the Citizen's National Bank (mainly for small clients, lending limit \$25,000 equivalent);
- Credit Guarantee Scheme: credit guarantees may be issued by banks on any loan to a small enterprise with limits of Won 20 million (\$50,000 equivalent) for working capital loans, Won 30 million (\$75,000 equivalent) for equipment loans and for export and import trade loans.

1/ Small-scale industry financing in Korea is studied in detail in Financing Small Scale Industry, Research Project (RPO 277) (in draft).

2/ In the MIB Act defined as companies employing less than 200 workers or with fixed assets below Won 50 million.

- technical assistance: an extension Services Department was set up within MIB in 1967 providing--at nominal fees-- plant consulting services, feasibility studies, correspondence services, training courses and seminars and issuance of guidance publications; services are not necessarily related to MIB's lending activities; technical assistance is also performed by other institutions such as the Korea Productivity Center and the Federation of Small and Medium Cooperatives;
- industrial estates: are mainly geared to small and medium industries (see also para 6).

EAP Projects Department
February 26, 1975

KOREA DEVELOPMENT BANKInterest Rates Charged by KDB, December 31, 1974

<u>Source of Funds</u>	<u>Type of Loans</u>	<u>Interest Rate (p.a.)</u>
Government Funds	Special Fund Loans	7.5%
	Equipment Fund Loans	10.0%
	Operating Fund Loans	15.5%
Machine Industry Promotion Funds	Equipment Fund Loans	12.0%
	Operating Fund Loans	12.0%
National Investment Fund	All Loans	12.0%
Tourism Development Fund	All Loans	7.5%
Industrial Rationalization Fund	All Loans	12.0%
Special Finance Debentures	All Loans	8.0%
Internal Funds	Equipment Fund Loans	
	Major Industries	12.0%
	Other Industries	15.5%
	Operating Fund Loans	15.5%
Foreign Funds	Equipment Fund Loans	
	Major Industries	12.0%
	Other Industries	15.0%
	Operating Fund Loans	
	Major Industries	14.0%
ADB Loan Funds	1st and 2nd Loans	8.0%
	3rd Loan	10.0%
KfW Loan Funds	1st Loan	8.0%
	2nd Loan	10.0%
	3rd Loan	9.0%
ADB Loan Funds	1st Loan	8.0%
	2nd and 3rd Loans	9.5%
Loans Overdue	All Loans	25.0%

EAP Projects Department
February 26, 1975

KOREA DEVELOPMENT BANK
Rates of Interest in Korea, December 31, 1974

Bank of KoreaRates Per Annum

Loans:	Commercial Bills	13.0%
	Exports	3.5%
	Agriculture and Fishery	6.0%
	Other Bills	
	Prime Enterprises	12.0%
	Others	14.0%
Discounts:	Prime Enterprises	9.0%
	Others	11.0%

Commercial Banks

Loan Rates:	Discounts on Bills	15.5% (18.0%)
	Loans for Exports	9.0%
	Loans for Machine Industry Promotion	10.0%
	Loans for Equipment for Export Industry	12.0%
	Loans with NIF	9.0%
	Call Loans	15.0%
	Loans or Other Bills	15.5% (16.0%)
	Overdrafts	17.5% (18.0%)
	Loans Overdue	25.0%
Deposit Rates:	Time Deposits:	
	3 months	15.0%
	6 months	15.0%
	12 months	15.0%
	Installment Savings	13.2%

Note: Figures in parenthesis apply to banks with localized operations.

Medium Industry Bank

Bank Funds:	Varying	9.0 - 15.0%
Government Funds:	Equipment Fund Loans	10.0%
	Operating Fund Loans	15.5%
	Cooperative Borrowers Fund Loans	12.0%
Foreign Loan Funds:		
	Funded from: AID and OECF, Japan	8.0%
	Exim Bank	8.25%
	KfW	9.0%
	ADB	10.25%

Korea Development Finance Corporation

Domestic Currency Loans	15.5%
Foreign Currency Loans	11.0%

KOREA DEVELOPMENT BANK

Policy Statement ^{1/}

Economic Role of KDB

1. The KDB shall assist in the economic development of Korea in conformity with its purposes as stated in the Korea Development Bank Act (KDB Act) enacted 30 December 1953, as amended, its By-Laws enacted 16 February 1954, as amended, and the other regulations governing its operations.

Operations

2. The KDB will carry out its operations in accordance with sound management and banking principles and practices. It shall endeavour to specialize in extending capital funds to such industries as are designated by the Government's economic plans or decrees as priority industries as well as other major basic industries which form the sub-structure of the economy. KDB may also make equity investments, provide working capital loans and render managerial and technical assistance to its Borrowers when the need arises. KDB will also extend guarantees on behalf of client enterprises. KDB, however, will not compete with other financial institutions in lending and administering industrial funds to assist major industries.

Project Selection

3. It will finance enterprises which are soundly managed and which appear, on careful economic, financial and engineering investigation to be viable. Following sound banking practices, the projects will be analyzed taking the following factors into consideration before making a commitment of financial assistance: (a) national economic benefits; (b) technical feasibility; (c) financial soundness and profitability; (d) marketability; and (e) quality of management.

Criteria for Selection of Borrowers

4. In its operations, preference will be given to the following major industries:

- (a) Generation, transmission and supply of electricity;
- (b) Coal-mining;
- (c) Ship-building;
- (d) Iron and steel manufacturing;

^{1/} Revised; to be adopted as a condition of effectiveness.

- (e) Electronics;
- (f) Export industries, designated by the Government to produce export commodities;
- (g) Import-substitution industries and industries producing raw materials necessary for export and import-substitution;
- (h) Indigenous industries and labor intensive industries; and
- (i) Such other industries as may be designated by the Government's economic plans or decrees as priority industries.

Qualifications for Eligible Borrowers

5. Eligible borrowers for KDB financing must meet the following qualifications:

- (a) Borrowers must be financially sound;
- (b) Borrowers must possess management and technical capacity for implementing the projects being financed;
- (c) Borrowers should not have defaulted on any of their outstanding obligations to the KDB.

Maximum Investment and Assistance

- 6. (a) KDB shall not subscribe to and/or underwrite stocks (including investment certificates) if the paid-up amount of the stocks so held by KDB will exceed KDB's own paid-up capital;
- (b) KDB shall not normally make equity investments in any single enterprise in excess of either:
 - (i) fifteen percent (15%) of the total unimpaired paid-up capital, surplus, and free reserves of KDB; or
 - (ii) fifty percent (50%) of the paid-up capital of the enterprise;

- (c) KDB shall not normally extend financial assistance to any single enterprise which exceeds either of the following ceilings:
 - (i) twenty-five percent (25%) of KDB's total unimpaired paid-up capital, surplus and free reserves;
 - (ii) sixty-five percent (65%) of the total assets of the enterprise.

Foreign Exchange Risk

7. As a general policy, KDB shall cover itself adequately against foreign exchange risks in the conduct of its operations. However, in using "revolving funds" generated in the case of some foreign borrowings, KDB may assume the exchange risk temporarily. Also in using some funds provided under the Industrial Rationalization Fund Scheme, KDB may be exposed to the exchange risk. To cover the risk in the latter case, KDB will make provision amounting to 1.5% of such funds outstanding from time to time. Exchange losses exceeding the provision made by KDB, will be reimbursed by the Government.

Security Arrangements

- 8. (a) In accordance with normal business practices, KDB will obtain adequate security for its loans and guarantees. In extending a loan to an enterprise, KDB shall require such enterprise to provide security the value of which shall be not less than 125% of the amount of the loan. In the case of guarantees covered by a Government counter-guarantee the value of security shall be not less than the amount guaranteed, and in all other cases of guarantees, shall be not less than 120% of the principal amount covered under such guarantees.
- (b) KDB may waive any of the foregoing requirements in cases where the credit or the guarantee is extended in favor of those enterprises enumerated in paragraph 2, Article 10 of the Operating Manuals of KDB as of the date of this Policy Statement, provided, however, that in such cases KDB will endeavor to secure a guarantee or counter-guarantee from the Government or from a suitable bank or banks to cover the credit or guarantee granted.

Technical Assistance

9. KDB will endeavor to provide its sub-borrowers with the necessary technical services including assistance for upgrading production efficiency and solving complicated technical difficulties. It will observe the operation of its sub-borrowers and will, whenever necessary, promptly make available to them constructive and remedial advice on the operation of the project. When considered necessary, KDB will also dispatch its own staff to the project companies.

Management and Organization

10. To build and strengthen its own management and staff as well as to assist clients in the formulation and execution of their projects, KDB will maintain an effective organization and an adequate staff, including financial and economic analysis, engineering, accountancy, marketing and legal services.

Share-Holding Fund

11. KDB shall administer the Share-holding Administration Fund (the Fund) pursuant to the provisions of the KDB Share-holding Act (Act No. 2128, enacted 4 August 1969) as a separate and distinct account in KDB's official books, the Fund will be treated as segregated from the other transactions and resources of KDB in accordance with the provisions of said Act.

Financial Policies

12. KDB shall conduct its operations according to the provisions of the KDB Act. It shall endeavor to match the maturity of its liabilities with those of its assets. It will continually review the charges it levies for the financial assistance it provides to ensure that it receives an adequate "spread" to cover all its expenses including provisions for doubtful loans and investments, and to enable it to build reserves as required legally and as considered necessary by the management.

KOREA DEVELOPMENT BANK

Board of Executive Directors as of December 31, 1974

1. Mr. Woun Gie Kim,
Governor
Appointed Governor of KDB in August, 1972. Career spent mainly in Ministry of Finance. Last Position: Vice Minister in the Ministry of Finance. Age: 50.
2. Mr. Won Taek Shim,
Deputy Governor
Joined KDB in 1943, and was promoted as Director of a department in 1967. Appointed as Executive Director in 1968 and Deputy Governor in 1971. Age: 51.
3. Mr. Chun Woo Lee
Joined KDB in 1943 and was promoted as Director of a department in 1965. Appointed as Executive Director in 1968 and reappointed in 1972. Age: 54.
4. Mr. Dang Yoon
Joined KDB in 1951 and was promoted as Director of a department in 1964. Appointed as Executive Director in 1968. Age: 54.
5. Mr. Ki-Yung Chung
Joined KDB in 1942 and was promoted as Director of a department in 1967 and appointed as Executive Director in 1970. Age: 50.
6. Mr. Eung Suh Park
Joined KDB in 1953 and was promoted as Director of a department in 1968. Appointed as Executive Director in 1971. Age: 51.
7. Mr. Wan Soo Han
Joined KDB in 1953 and was promoted as Director of a department in 1968. Appointed as Executive Director in 1971. Age: 51.
8. Mr. Chan-Yul Lee
Joined KDB in 1941 and was promoted as Director of a department in 1962. Appointed as Executive Director in 1972. Age: 53.
9. Mr. Joon Park
Joined KDB in 1942 and was promoted as Director of a department in 1967. Appointed as Executive Director in 1974. Age: 51.

KOREA DEVELOPMENT BANK
Operational Program for FY 1974

(In Million Won)

I. Uses of Funds

<u>Classification</u>	<u>Loan</u>	<u>Investment</u>	<u>Total</u>
<u>Capital Fund</u>			
Important Ind. Fund			
Electricity	7,673	-	7,673
Coal Mining	1,000	-	1,000
Shipbuilding	2,100	-	2,100
Iron & Steel	2,600	9,500	12,100
Manufacturing of Semi-Conductors for Communication Equipment	-	-	-
Overseas Freight Lines Shipping	150	-	150
<u>Sub-total*</u>	<u>13,523</u>	<u>9,500</u>	<u>23,023</u>
Other Ind. Fund			
Mining & Quarrying	2,700	-	2,700
Manufacturing	17,710	1,071	18,781
Waterworks & Gas	-	1,832	1,832
Construction	500	-	500
Tourism	1,000	-	1,000
Transportation & Communication	10,800	-	10,800
Services	2,420	1,000	3,420
Others	16,000	-	16,000
<u>Sub-total</u>	<u>51,130</u>	<u>3,903</u>	<u>55,033</u>
<u>Total Capital Fund</u>	<u>64,653</u>	<u>13,403</u>	<u>78,056</u>
<u>Operating Fund</u>	<u>10,770</u>	<u>-</u>	<u>10,770</u>
<u>Total</u>	<u>75,423</u>	<u>13,403</u>	<u>88,826</u>

* Indicates the funds for those sectors of industries as stated in Article 18 (1) of the KDB Act.

II. Sources of Funds

Classification

Increase of Capital	9,500
Increase of Reserves	2,105
Borrowings from Government	20,239
	(2,514)
Issuance of Industrial Finance Debentures	23,798
	(10,995)
Increase of Deposits	(15,668)
Borrowings of Foreign Capital	44,168
	(5,283)
Collection of Capital Loans	12,000
Collection of Operating Loans	7,500
Sales of Stocks Held	2,494
Miscellaneous	1,482
<u>Total</u>	<u>88,826</u>

- Notes: 1) Figures in parenthesis indicate repayment or redemptions.
- 2) The above program was approved by the Government on March 5, 1974 and by the KDB's Board of Executive Directors on March 12, 1974.

KOREA DEVELOPMENT BANK

Summary of Loan Operations, 1969-1974
(Won in million)

Years ending December 31	1969		1970		1971		1972		1973		1974	
	No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Amount
<u>Domestic currency loans</u>												
Commitments:												
Capital loans	340	29,572	288	24,752	327	31,883	649	116,629	379	76,461	452	100,702
Operating loans	623	11,029	418	17,680	379	15,233	574	24,054	684	18,018	713	28,243
Total commitments	963	40,601	706	42,432	706	47,116	1,223	140,683	1,063	94,479	1,165	128,945
Disbursements ^{1/}	-	40,601	-	42,432	-	47,116	-	140,683	-	94,479	-	128,945
Repayments	-	10,681	-	11,331	-	20,762	-	63,065 ^{2/}	-	22,909	-	34,895
Net outstanding at the end of the year	1,571	92,980	1,578	124,081	1,545	150,435	1,604	228,053	1,714	299,623	1,773	393,673
<u>Foreign currency loans</u>												
Commitments	12	2,563	5	3,742	26	13,236	12	13,350	41	10,599	58	24,255
Disbursements	-	1,140	-	1,881	-	1,892	-	4,794	-	9,202	-	15,535
Repayments	-	309	-	120	-	(283)	-	793	-	1,435	-	2,362
Net outstanding at the end of the year	155	3,123	214	4,884	201	7,059	206	11,080	257	18,847	297	32,020
<u>Total loans</u>												
Commitments	975	43,164	711	46,174	732	60,352	1,235	154,033	1,104	105,078	12,234	153,200
Disbursements	-	41,741	-	44,313	-	49,008	-	145,477	-	103,681	-	144,480
Repayments	-	11,990	-	11,451	-	20,479	-	63,838	-	24,344	-	37,257
Outstanding at the end of the year	1,726	96,103	1,792	128,965	1,746	157,494	1,810	239,133	1,971	318,470	2,070	425,693

1/ According to the standard banking practice in Korea, KDB credits its sub-borrowers' domestic currency loan accounts immediately after making a commitment. Consequently domestic currency commitments are equal to disbursements in all the years. The amounts not drawn down by the sub-borrowers from their respective loan accounts are shown under 'Credit Control Account' - a current liability item. The outstanding balances under Credit Control Accounts as of the end of 1969 through 1974 were as follows:

Years ended December 31	Amount (Won in million)
1969	979
1970	5,403
1971	4,721
1972	2,539
1973	3,718
1974	4,189

2/ Includes repayment of loans (₩25.77 billion) under the overall scheme of economic reforms introduced by the government in August, 1972.

3/ Includes adjustments in loan amounts on account of exchange rate fluctuations.

KOREA DEVELOPMENT BANK

Analysis of Loan, Equity Investment and Guarantee Commitments as of December 31, 1973
(Won in billion)

	Loans			Equity Investments			Guarantees			Total Portfolio		
	No.	Amount	%	No.	Amount	%	No.	Amount	%	No.	Amount	%
Types of Assistance												
Domestic currency	1,707	299,623	94.1	-	58,642	100.0	- 1/	46,117	5.9	- 1/	404,382	34.7
Foreign currency	264	18,847	5.9	-	-	-	- 1/	741,308	94.1	- 1/	760,155	65.3
Total	1,971	318,470	100.0	44	58,642	100.0	786	787,425	100.0	2,801	1,164,537	100.0
Ownership												
Private sector	1,556	104,850	32.9	1	857 2/	14.6	547	423,897	53.8	2,104	529,604	45.5
Public sector	415	213,620	67.1	43	57,785 2/	85.4	239	363,528	46.2	697	634,933	54.5
Total	1,971	318,470	100.0	44	58,642	100.0	786	787,425	100.0	2,801	1,164,537	100.0
Nature of Project												
New	- 1/	204,450	64.2	- 1/	3,242	5.5	- 1/	304,735	38.7	- 1/	512,427	44.0
Existing	- 1/	114,020	35.8	- 1/	55,400	94.5	- 1/	482,690	61.3	- 1/	652,110	56.0
Total	-	318,470	100.0	-	58,642	100.0	-	787,425	100.0	-	1,164,537	100.0
Sectoral Distribution												
Agriculture, forestry & fishery	1	332	0.1	-	-	-	1	10,327	1.3	2	10,659	0.9
Mining & quarrying	2	15,545	4.9	1	314	0.5	-	-	-	3	15,859	1.4
Electricity & waterworks	5	122,619	38.5	1	2,388	4.1	4	254,639	32.3	10	379,646	32.6
Construction	4	10,690	3.4	1	700	1.2	1	4,831	0.6	6	16,221	1.4
Manufacturing												
Food, beverage & tobacco	27	7,178	2.3	1	300	0.5	2	15,101	1.9	30	22,579	1.9
Textile, wearing apparel & leather	92	17,512	5.5	-	-	-	8	71,914	9.2	100	89,426	7.7
Wood & wood products	9	2,242	0.7	-	-	-	2	761	0.1	11	3,003	0.3
Paper & paper products, printing	24	4,794	1.5	2	175	0.3	4	1,050	0.1	30	6,019	0.6
Chemicals, petroleum, coal, rubber & plastic	35	18,975	6.0	3	19,931	34.0	20	144,268	18.3	58	183,174	15.7
Non-metallic mineral products	28	10,592	3.3	1	100	0.2	12	65,862	8.4	41	76,554	6.6
Basic metals	19	27,249	8.6	6	26,991	46.0	7	68,506	8.7	32	122,746	10.5
Fabricated metal products, machinery & equipment	63	32,585	10.2	2	3,908	6.7	15	106,468	13.5	80	142,961	12.3
Others	5	272	0.1	-	-	-	1	283	0.0	6	555	-
Sub-total	302	121,399	38.2	15	51,405	87.7	71	474,213	60.2	388	647,017	55.6
Transportation	117	25,662	7.8	-	-	-	1	36,802	4.7	118	62,464	5.4
Banking & insurance	20	18,833	5.9	2	665	1.1	1	3,320	0.4	23	22,818	1.9
Hotel & tourism	26	3,255	1.1	1	500	0.8	1	423	0.1	28	4,178	0.3
Other services	10	135	0.1	8	2,670	4.6	3	2,870	0.4	21	5,675	0.5
Total	487 3/	318,470	100.0	29 3/	58,642	100.0	83	787,425	100.0	599 3/	1,164,537	100.0
Geographical Distribution 4/												
Seoul City	742	135,992	38.0	-	10,519	17.2	211	198,007	22.6	-	344,518	26.6
Kyung-gi Province	261	55,457	15.5	-	15,799	25.8	53	76,104	8.7	-	147,360	11.4
South Chungcheong Province	67	10,073	2.8	-	-	-	13	12,179	1.4	-	22,252	1.7
North Chungcheong Province	102	15,034	4.2	-	5,650	9.2	36	53,131	6.1	-	73,815	5.7
Kang Won Province	88	14,615	4.1	-	-	-	52	69,267	7.9	-	83,882	6.5
South Jeon-ra Province	81	9,391	2.6	-	-	-	32	47,701	5.4	-	57,092	4.4
North Jeon-ra Province	59	4,873	1.4	-	-	-	11	7,121	0.8	-	11,994	0.9
South Kyungsang Province	115	21,688	6.1	-	16,153	26.4	139	140,225	16.0	-	178,066	13.7
North Kyungsang Province	156	37,920	10.6	-	12,700	20.8	101	107,346	13.3	-	157,966	12.2
Busan City (including Cheju Island)	284	52,473	14.7	-	350	0.6	148	65,534	8.8	-	218,357	16.9
Total	1,955	357,516	100.0	1/	61,171	100.0	796	876,615	100.0	1/	1,295,302	100.0
Size of Assistance (Won)												
0 - 8,000,000	319	909	0.3	-	-	-	26	97	0.0	345	1,006	-
8,000,001 - 20,000,000	314	3,820	1.2	2	20	0.0	60	524	0.1	376	4,364	0.4
20,000,001 - 40,000,000	309	7,053	2.2	1	22	0.0	65	988	0.1	375	8,063	0.7
40,000,001 - 120,000,000	543	31,574	9.9	5	250	0.4	118	5,863	0.7	666	37,687	3.2
120,000,001 - 200,000,000	194	25,186	7.9	4	696	1.2	68	5,576	0.7	266	31,457	2.7
200,000,001 - 400,000,000	152	37,744	11.9	9	1,493	2.6	79	12,457	1.6	240	51,694	4.4
400,000,001 - 800,000,000	83	41,358	13.0	12	4,933	8.4	108	26,643	3.4	203	72,934	6.3
800,000,001 - 2,000,000,000	39	57,445	18.0	7	4,362	7.5	115	69,763	8.9	161	131,570	11.3
2,000,000,001 - and above	18	113,381	35.6	4	46,866	79.9	147	665,515	84.5	169	825,762	70.9
Total	1,971	318,470	100.0	44	58,642	100.0	786	787,425	100.0	2,801	1,164,537	100.0

41/ Not available.

2/ Companies whose majority shareholding (more than 50%) is held by KDB are grouped as public sector companies.
Such investment amounted to ₩ 22.75 billion in 11 companies.

3/ Number of companies assisted.

4/ Position as of June 30, 1974.

KOREA DEVELOPMENT BANK

Summary of Investment Operations, 1969-1974
(Won in million)

Years ending December 31	1969	1970	1971	1972	1973	1974
I. Equity Investment						
Total investment at the beginning of the year	12,865	26,858	46,723	48,514	63,262	58,642
Acquisitions during the year:						
Direct purchases	8,307	6,853	2,972	5,860	2,649	10,671
Conversion of loans	6,201	2,252	2,989	17,534	-	-
Transfer from Government	-	12,250	1,506	-	349	-
Total acquisitions	14,508	21,355	7,467	23,394	2,998	10,671
Investments sold during the year	515	1,490	5,676	8,646	7,618	3,430
Net investments at the end of the year:						
Direct purchases	9,714	15,077	16,696	22,547	25,196	43,107
Conversion of loans	7,642	9,894	11,291	21,038	18,611	17,353
Transfer from Government	9,502	21,752	20,527	19,677	14,835	5,423
Total	26,858	46,723	48,514	63,262	58,642	65,883
Dividend income	471	582	750	883	2,356	2,339
Dividend income as % of average investments	2.4	1.6	1.6	1.6	3.9	3.8
Capital gains realized	2	14	-	257	956	1,320
Capital gains as % of cost of investment sold	-	0.9	-	3.0	12.5	38.5
Dividend income plus capital gains as % of average investments	2.4	1.6	1.6	2.0	5.4	7.5
II. Bonds and Debentures						
Total investment at the beginning of the year	5,798	7,624	8,971	9,114	8,830	8,864
New investment during the year	2,581	1,841	741	410	920	1,684
Sub-total	8,379	9,465	9,712	9,524	9,750	10,548
Investments sold	755	494	598	694	886	472
Net investments at the end of the year	7,624	8,971	9,114	8,830	8,864	10,076
Interest income from investments	604	764	766	841	829	775
Interest income as % of average investments	9.0	9.1	8.5	9.4	9.4	8.2
III. Total Investment (equity shares, bonds & debenture)						
Investment at the beginning of the year	18,663	34,482	55,694	57,628	72,092	67,506
Acquisitions during the year	17,089	23,196	8,208	23,804	3,918	12,355
Sub-total	35,752	57,678	63,902	81,432	76,010	79,861
Sales	1,270	1,984	6,274	9,340	8,504	3,902
Net investments at the end of the year	34,482	55,694	57,628	72,092	67,506	75,959
Total income from investment portfolio (dividends, capital gains and interest income)	1,077	1,360	1,730	1,981	4,141	5,434
Yield on investments (%)	4.1	3.0	3.1	3.1	5.9	7.6

KOREA DEVELOPMENT BANKBrief Description of Readjustment Corporation and Korea
Industrial Leasing Company, Ltd.Readjustment Corporation (RC)

1. Readjustment Corporation (RC) was set up in February 1962 by a Cabinet Decree as a wholly owned subsidiary of KDB. The basic objectives and functions of RC are (a) to protect and collect claims transferred to it by KDB and other banking institutions in the country and (b) to manage and dispose of properties taken over and those transferred to it by KDB, which had been acquired by KDB as a result of foreclosures. About two-third of the accounts handled by RC have emanated from KDB and the remaining one-third from other banking institutions. RC collects claims through foreclosure proceedings and disposal of debtors' properties. It invariably participates in the biddings, and properties so acquired are subsequently sold at an appropriate time when such sales can fetch best prices. The amounts collected by RC through purchase of properties and this subsequent sales are applied first towards settlement of KDB claims and the balance, if any, is retained by RC. In case of collections directly through foreclosures, the excess of KDB's and RC's claims is refundable to the sub-borrower. KDB's claim consists of the capital amount plus interest accrued up to the time the particular account was transferred to RC. Interest accrued after the date of transfer of account to RC goes to RC and constitutes its income. The same principles governs conduct of RC's business relations with other banking institutions.
2. RC's total paid-in capital is W 565 million, all of which was contributed by KDB in the form of transfer of its claims (W 485 million) and properties (W 80 million). Since its inception up to June 30, 1974), KDB transferred its claims (including those as its contribution to RC's paid-in capital) aggregating W 30.1 billion of which claims in an amount of W 13.3 billion have been settled (up to June 30, 1974). Out of the unsettled amount of W 16.8 billion, RC had settled/sold claims/properties amounting to W 10.4 billion (including a write-off of W 5.7 billion) and was in the process of collecting the proceeds. Against the balance amount (W 6.4 billion) RC was holding 140% collateral. RC's financial performance up to 1972 was marginal (average income during 1968 to 1972 was W 44 million or 5.3% of average network) but it considerably improved in FY73. RC's net income in the first nine months ended September 30, 1973 was W 400 million or 35% of average net worth. In terms of its Charter (Cabinet Decree) entire income of RC is transferred to reserves.
3. RC is managed by a Board of Directors comprising a President, three Directors and two auditors including one full time auditor. The

President as well as other members of the Board of Directors are appointed, on the recommendation of the Governor of KDB, by the Minister of Finance who supervises, again through the Governor of KDB, RC's overall operations.

Korea Industrial Leasing Company Limited (KIL)

4. KIL was incorporated in December 1972 as a wholly owned subsidiary of KDB. Its major functions are leasing and buying and selling of industrial machinery and equipment and other facilities, real estates and patents, etc. KIL is managed by a Board of Directors (one president, one directors and one auditor) who in terms of its by-laws are elected by the shareholders (they have all been appointed by KDB so far).

5. KIL's original paid-in capital was W 500 million all subscribed by KDB. In early 1974 the Government of Korea promulgated a Leasing Act which required all leasing companies to have a minimum paid in capital of W 1.5 billion. KDB therefore contributed an additional sum of W 1.0 billion towards KIL's paid in capital raising it to W 1.5 billion. In addition KDB has advanced a long-term loan of W 850 million to KIL. Plans are underway to attract foreign participation in KIL and thereby raise its paid-in capital to W 3.0 billion. If and when these plans are executed KDB's share in KIL's paid-in capital would reduce from the present 100% to 40%; it would no more remain a subsidiary of KDB.

6. KIL started its commercial operations in March 1973. During its 16 months operations (March 1973 to June 1974) KIL signed 30 lease contracts for a total amount of W 4.4 billion while 20 contracts for W 2.7 billion were actually executed (leased items delivered). It was a good beginning in the initial period yet the overall volume of operations was too small to be profitable. During the 16 months period ended June 30, 1974, KIL suffered a net loss of W 62 million. It was not due to any lack of market or business opportunities but to inadequacy of capital resources of KIL. A positive step to correct this situation has already been taken through raising of KIL's paid in capital by W 1.0 billion and as stated in the previous paragraph, KDB is planning to increase the capital further to W 3 billion by foreign investment.

ANNEX 9

KOREA DEVELOPMENT BANK

Summary of Guarantee Operations, 1969-1974
(Won in million)

	1969		1970		1971		1972		1973		1974	
	During the year	At the end of the year	During the year	At the end of the year	During the year	At the end of the year	During the year	At the end of the year	During the year	At the end of the year	During the year	At the end of the year
Foreign currency guarantees issued	128,656	262,740	148,172	384,088	196,278	554,186	113,056	590,741	247,225	741,308	591,486	1,246,705
Domestic currency guarantees issued:												
Local payment guarantees	21,896	20,291	16,862	28,905	12,887	34,413	7,196	9,574	49,666	22,055	17,520	32,288
Local repayment guarantees	15,506	16,207	9,758	10,744	6,899	11,190	4,553	10,068	15,111	21,936	4,149	24,814
Others	540	540	-	480	120	540	438	916	1,736	2,126	6,416	7,334
Total domestic currency guarantees	37,942	37,038	26,620	40,129	19,906	46,143	12,187	20,558	66,513	46,117	28,085	64,436
Total guarantees issued	166,598	299,778	174,792	424,217	216,184	600,329	125,243	611,299	313,738	787,425	619,571	1,311,141
Guarantees redeemed	42,150		50,353		40,072		114,273		137,612		95,855	
Guarantee commission earned	1,263		2,125		3,064		3,831		3,683		4,420	
Guarantee commission as % of average outstanding guarantees	0.5		0.6		0.6		0.6		0.5		0.4	

KOREA DEVELOPMENT BANKKDB's Role in the EconomyKDB in Perspective

1. KDB is the largest long-term lending institution in Korea with a share of 46% (US\$530 million) of total medium- and long-term loans outstanding by the banking sector at the end of October 1974, and it directly financed 8% of total fixed capital formation in 1973. As KDB on the average finances about one third of total project cost of its clients and if guarantees are included, KDB was involved in over 40% of fixed investment in the country in 1973. The foreign currency portion of its total guarantee portfolio (US\$1.5 billion equivalent) accounted for 38% of Korea's total foreign medium- and long-term debt at year end 1973).

2. KDB finances nearly all sectors in the economy except Housing, Agriculture and Fisheries for which Korea now has specialized institutions. Most of its lending is concentrated in manufacturing and power generation which together accounted for 75% of KDB's portfolio as of June 30, 1974. In 1973, disbursements to Korea Electric Company (KECO), the national electricity company, amounted to \$41 million equivalent (49% of fixed capital formation in the power sector). KDB is the major channel for the Government to invest in KECO and to supply the electricity sector with low interest loans. KDB therefore accounts for almost 100% of total medium- and long-term electricity loans outstanding of all banking institutions. Disbursements to the manufacturing sector amounted to US\$95 million in 1973 (15% of fixed capital formation) and of all lending institutions in Korea it is the largest source for medium- and long-term funds for manufacturing (its outstanding loans at the end of 1974 amounted to US\$158 million equivalent or 40% of all medium- and long-term advances by the banking sector, including KDFC).

Economic Impact of KDB-lending

3. By the sheer size of its financing and guarantee business KDB has played an important role in Korea's economic development. Early in Korea's post-Korean War development it was selected by the Government as its major agency for implementing industrial policies and as its prime channel for promoting the development of large-scale priority projects. As of 1972, KDB had assisted 325 industrial enterprises that employed 250,000 workers (26% of total employment in industry) and whose output, in 1972, was valued at US\$1.2 billion equivalent (25% of total industrial output). Many of KDB assisted projects are very capital intensive (steel mills, petrochemical

plants) and for a sample of 109 projects completed between 1970 and 1973, the average cost per job was about US\$14,000 ^{1/} compared to a national average in 1972 of about US\$4,200. If the two steel plants and three petrochemical plants are excluded from the sample, the average cost per job would decrease to US\$4,100. In compliance with Government policy, KDB has effectively assisted many export-oriented enterprises which, in 1972, represented 41% of the country's total manufacturing exports. Though recently the Government has declared a wider geographic distribution of manufacturing as an objective to increase industrial job opportunities for its rural labor force, KDB's portfolio still reflects the overall geographic distribution of Korea's manufacturing sector: 68% of KDB's total assistance went to Seoul and Bussan provinces. ^{2/}

4. KDB assists both the public and private sectors, though only 35 of the total of 544 clients of as of December 1973 belonged to the public sector. 71% of all assisted enterprises are joint stock companies accounting for 95% of all outstanding loans, investments and guarantees as of December 31, 1973. KDB has about 100 clients with individual partnership, 75% of which had no previous manufacturing experience thus contributing to the entrepreneurial base in the country. KDB has also supported 23 joint venture enterprises importing capital and technical/marketing know how into the country (the foreign partners own 58% of the total share capital). KDB has also contributed to Korea's economic growth by promoting new projects which over the last three years accounted for about 50% of its total assistance.

5. Economic Rates of Return. KDB does not routinely use the Economic Rate of Return (ERR) concept in its appraisals, but at the request of the Appraisal Mission calculated the internal rates of return for a sample of 28 projects. ^{3/} The methodology suggested by the Bank to DFCs associated with the World Bank Group was followed and the exercise was competently handled. The results of the exercise are summarized below:

-
- ^{1/} For comparison, a sample of 45 projects financed by the Development Bank of the Philippines in 1972/73 showed that the average cost per job was the same US\$14,000.
 - ^{2/} In 1972, 74% of the manufacturing sectors value added was produced in these two provinces, which also located 79% of all enterprises employing 200 or more workers.
 - ^{3/} The sample was selected from projects appraised by the Foreign Loan Department that handles projects financed from foreign funds. The sample is distributed along KDB's fields of financing in manufacturing but does not include large priority projects such as steel mills or petrochemical plants. It does include 6 projects costing more than US\$2 million each and 8 projects where total investment costs were below US\$500,000 each. 3 of the companies are fairly large with total assets over \$10 million each while 7 companies had total assets of less than US\$500,000 each at the time of loan application. 12 projects were not completed while 10 had been in in operation for over one year. 16 projects are expansion projects while 12 are new and 11 projects export 50% or more of their output.

<u>Percentage Range</u>	<u>FRR</u>	<u>ERR</u>
12.0 - 17	6	4
17.1 - 22	9	7
22.1 - more	13	17

6. All projects had an Economic Rate of Return higher than the present estimate of the opportunity cost of capital (12%) in Korea. Only four projects had ERR of 17% or less; at the other extreme, three projects had ERR in excess of 50%. The average ERR was 30%, higher than the average FRR of 22% and only 3 projects had an ERR that was lower than the FRR. ERR's were higher for non-completed projects (36%) calculated on the basis of assumed costs and prices than for projects already in operation (26%) where actual data was used. This could be a reflection of optimistic assumptions or it could also be the result of a lowering of effective protection rates in the country. Surprisingly, non-export projects did better (33%) than export projects (27%) though three of the four projects with a low ERR are producing mainly for the domestic market. The three projects with the highest ERR are all producing for the domestic market; two are pharmaceutical projects with no or very low effective protection and high financial profitability (one of them produces a cold remedy specific to Korea) and the third project produces news print for which the domestic price is government regulated.

7. The results of the ERR exercise given in the foregoing cannot be considered as exact because many approximations were needed. However, the figures indicate fairly the order of magnitude. The calculations also reflect the fact that the criteria KDB used so far in its project selection process have proved effective (even though the ERR concept has not been used) and its priorities have been right from an economic point of view. The generally satisfactory ERRs are not surprising because Korea's industrial development policies and priorities have been highly successful and by adhering to them closely, KDB made right decisions in allocating resources that it mobilized.

Resource Mobilization

8. As at December 31, 1974, KDB had total resources of W 629 billion (US\$1.3 million) 84% of which were in domestic currency. As a wholly owned government development bank, KDB depends to a large extent on the funds provided by the Government. Because of KDB's special role in financing priority projects at preferential interest rates, it relies heavily on low cost borrowings from the Government. In addition to providing funds in the form of equity (24% of total resources), the government has given loans to KDB (23%), subscribed to its industrial finance debentures under the Industrial Rationalization Fund (8%), provided funds from the NIF (7%) and a small amount of Tourism Development funds from the Ministry of Transportation. KDB's domestic resource mobilization at market rates has been limited to (1) the issuance of regular Industrial Finance Debentures (W 75 billion

to (1) the issuance of regular Industrial Finance Debentures (W 88 billion or 15%) that were subscribed by commercial banks (42%) and the rest by individuals at an effective rate of 14% per annum, and (2) by acceptance of demand deposits and time deposits from its existing clients (7% of total). KDB has also used a considerable portion of its borrowings from foreign commercial banks in domestic currency (7% of total domestic resources).

9. At December 31, 1974 foreign currency resources stood at \$208 million (16% of total resources). Until 1970, when KDB received its first line of credit from ADB, foreign resources were allocated by the government from loans from USAID and KfW. Since 1970, however, KDB's own efforts have gained momentum and it has been able to obtain 3 lines of credit from ADB totalling \$60 million, and in 1970 and again in 1974 was able to obtain Euro-dollar loans for \$25 million and \$80 million respectively, the second without government guarantee. Raising money from commercial sources is difficult for KDB as international interest rates are close to Korea's long-term lending rate ceilings. However, even at the Euro-dollar rate plus a mark up and with the borrower having to bear the exchange risk, KDB was able to commit the second Euro-dollar loan very quickly as credit was tight and the demand for medium- and long-term funds was heavy. In November 1974, KDB borrowed US\$19 million equivalent from Abu Dhabi and expects to tap the Middle East and Arab capital market again in 1975.

10. Besides the direct resource mobilization, KDB has been instrumental in raising resources indirectly by influencing its clients to raise their resources over and above those suggested in their loan applications. In a small sample of 22 projects committed out of the second ADB loan (US\$20 million), 8 sub-loans were made on the condition that the sub-borrowers would increase their capital contribution or obtain subordinated loans from major shareholders, thus raising an additional US\$2.9 million. The sample is admittedly small and does not represent an exact measure of KDB's indirect influence on resource mobilization. It does show, however, that KDB has had at least some positive influence on its clients' investment behavior and that it has not hesitated to use it. Overall, KDB finances about 30% of total project cost and therefore for each unit of its lending, there is usually a total investment of 3 units.

Other Developmental Activities

11. KDB performs several other unique operations in addition to industrial development financing. It carries out statistical surveys, conducts economic and industrial research, undertakes engineering surveys and business analyses and provides managerial assistance to its projects. Besides these regular activities, KDB has often been called upon by the Government to give its opinion on major policy issues and its departments have assisted in many government projects and programs (e.g. assisting in making the preliminary analysis of the Second 5-year Economic Plan or compiling basic worksheets for input-output analysis used to forecast industrial growth in specific

areas). KDB's management is also regularly represented in many important Government Committees such as the Economic Cabinet Meeting, Foreign Capital Inducement Deliberation Committee, Industrial Rationalization Council, Advisory Committee for Economic Planning and the NIF-Management Council.

12. Economic Research in KDB is done by three departments (Research, Business Analysis, and Technical). They provide support to management and operational departments on specific requests and perform, on a regular basis, studies and surveys many of which are published and receive wide circulation. For instance, KDB publishes an annual survey of financial condition of enterprises, a Monthly Economic Review, a half-yearly Survey on Equipment Investment and Program, a monthly Research Report and Weekly Economic Reports which present studies on current domestic and international economic issues such as recent developments and impact of world oil price systems, an introduction to the current revision of Japanese' Commercial law, a review on pollution measures, problems in joint ventures or a study on the current exchange rates. KDB has also published comprehensive industrial surveys and was the author of the book "Industry in Korea, 1970", which is presently being updated. In addition, in connection with KDB's own financing activities or upon the requests of outside sources, it conducts business analyses and provides managerial assistance. Direct consulting services are offered to those clients confronted with managerial difficulties, often in the form of deputation of KDB staff to the affected companies. KDB also conducts seminars on general management problems and publishes instructive materials on better managerial skills. In an attempt to improve appraisal capabilities of Korea's banking system, KDB keeps special credit files on all customers that received loans of over W 50 million. Other banks have, on request, access to these credit files. Lastly, KDB's technical department is asked by the Foreign Capital Inducement Deliberation Committee (FCIDC) to perform engineering surveys on all proposed projects requesting foreign loan guarantees. These surveys are the basis for decisions both of the FCIDC and subsequently of KDB.

EAP Projects Department
February 26, 1975

KOREA DEVELOPMENT BANK

Economic and Financial Rates of Return on a Sample of 28 KDB Financed Projects

	Type of Industry	Type of Project 2/	Capacity	Size of Asset of Company 1/ \$ 1,000	Share of Exports in Output %	Project Cost Local Foreign \$1,000 \$1,000		Share of KDB Financing %	Internal Rate of Return Financial Economic % %	
Not Completed:										
1. Sam Sung Pharmaceutical Ind. Co.	Pharmaceutical	E	Various quantities of insecticides & liquid digesters	4,309	2.6	781	350	31	52.7	77.3
2. Sae-Dae Paper MFG. CO.	Paper	E	6,000 MT news print	18,639	-	617	660	47	17.0	60.0
3. Dong a Pharmaceutical Ind. Co.	Pharmaceutical	N	19 million bottles cold remedy	16,081	-	1,078	200	16	27.4	52.6
4. Nam Jeon Ind. Co.	Miscellaneous	N	1.1 billion woven plastic bags	75	100	1,235	1,226	50	21.0	43.0
5. International Leather Ind. Co.	Leather	N	4.8 million S/F leather	125	100	2,133	1,036	33	25.8	41.8
6. Mi Jin Metal Ind. Co.	Metal Products	E	600,000 pairs of shoes	1,546	45	261	463	64	24.5	31.7
7. Masan Co.	Textiles	E	2.143 MT accrylic yarn	2,724	100	1,021	1,882	65	25.1	28.7
8. Samsung Special Paper Co.	Paper	E	3,500 MT carbonizing paper	1,639	100	1,112	502	31	21.0	26.0
9. Keum Kang Asbestos Cement Ind. Co.	N-M Minerals	N	1.7 million sheets asbestos cement board	10,310	-	3,061	476	13	35.0	24.2
10. Han Kook Ceramics	N-M Minerals	N	468,000 m ² mosaic tiles	1,615	100	811	521	39	18.5	22.0
11. Korea Bearing Co.	Metal Products	E	464,000 bearings	4,964	-	518	351	40	20.1	16.2
12. Tong Il Steel Mfg. Co.	Metal Products	N	6,341 MT wires, ropes	1,322	48	795	497	38	14.5	12.5
Completed:										
1. Oriental Precision Co.	Electronics	E	5,827 telephone switch boards	6,054	-	379	204	35	12.2	45.0
2. Lucky Ltd.	Miscellaneous	E	33 electronic point sets	1,632	-	116	103	47	18.2	40.0
3. Sam Kang Ind. Co.	Food	N	900,000 m sprayer vinyl hose	589	-	145	69	32	24.1	39.0
4. Dong Yang Warner Co.	Metal Products	E	2,280 MT canned vegetable	1,682	-	154	178	54	27.3	35.6
5. Daehan Livestock & Feed Co.	Food	N	192 MT ring gears and pinion sets	406	-	522	141	24	23.0	35.5
6. Bookook Steel & Wire Co.	Metal Products	N	2,400 MT chicken meat	1,464	100	263	247	48	19.8	29.1
7. Han Kook Food Ind. Co.	Food	E	720 MT aircraft cables	27	100	35	36	51	24.8	27.4
8. Hyun Dai Wool Textile Co.	Textiles	E	337 MT rice crackers	2,028	100	1,500	1,701	31	15.6	22.2
9. Tai Han Electric Wire Co.	Metal Products	E	2,364 accrylic yarn	3,910	26	497	557	55	18.7	21.9
10. Sam Kyung Trading Co.	Textiles	E	323 MT electric wire	2,933	50	271	162	37	23.4	21.8
11. Dae Han Pulp Inc.	Paper	E	260,000 yards polyester jersey	2,190	25	150	108	42	18.0	20.0
12. Sam-ah Aluminium Co.	Metal Products	E	1,450 MT corrugated manila board paper	443	29	1,819	876	25	19.5	18.2
13. Daeyle Yang Hang Co.	Food	N	992 MT aluminum foil	576	-	950	913	49	29.1	17.6
14. Daejung Commercial Co.	Textiles	N	172,000 R/L aluminum foil paper	248	100	190	589	72	13.0	17.1
15. Dong Heung Metal Ind. Co.	Metal Products	E	612 MT stretched yarn	34	-	120	80	40	28.7	13.3
16. Yechun Filature Co.	Textiles	N	450 MT alloy tool steel	4,053	100	178	119	40	5.3	12.3
			57,566 kg silk yarn							

1/ At time of application

2/ New (N) or Expansion (E)

EAP Projects Department
February 26, 1975

KOREA DEVELOPMENT BANKDetails of Long-Term Resources as of December 31, 1974

1. As of December 31, 1974 total long-term resources of KDB had amounted to W 628.73 billion (US\$1.30 billion equivalent) of which W 527.42 billion (US\$1.09 billion equivalent) or 83.9% were in domestic currency and W 101.31 billion (US\$208.87 million equivalent) or 16.1% were in foreign currency as follows:

	<u>W in billion</u>	<u>Equivalent US\$ in million</u>
<u>Domestic currency:</u>		
Paid-in capital	119.71	246.82
Reserves and retained earnings	<u>22.93</u>	<u>47.28</u>
Net owner's equity	142.64	294.10
Borrowings from Government of Korea	136.58	281.61
Industrial Finance Debentures	87.76	180.95
Revolving funds	(3.93) ^{/a}	(8.10) ^{/a}
Special Finance Debentures	26.73	55.11
Industrial Rationalization Fund	51.11	105.38
Tourism Development Fund	0.38	0.78
National Investment Fund	40.68	83.88
Deposits	<u>41.54</u>	<u>85.65</u>
Total domestic currency resources (% of total resources)	<u>527.42</u> (83.9%)	<u>1,087.46</u>
<u>Foreign currency:</u>		
USAID loans	13.28	27.37
KfW loans	8.00	16.50
ADB loans	29.10	60.00
Eurodollar loans from commercial banks	<u>50.93</u> ^{/b}	<u>105.00</u>
Total foreign currency resources (% of total resources)	<u>101.31</u> (16.1%)	<u>208.87</u>
Grand total of all resources	<u>628.73</u>	<u>1,296.33</u>

^{/a} Not included in the total of domestic currency resources as it is included in the total of foreign currency resources.

^{/b} W 46.3 billion from these borrowings were in fact used for making domestic currency loans.

2. Broad details of associated terms and conditions of borrowed resources of KDB are given in Annex 12. A brief review of each source is given below.

Domestic Currency Resources

3. Paid-in capital. As required by the KDB Act, its entire paid-in capital has been subscribed by the Government of Korea. The authorized capital of KDB is W 300 billion (US\$619 million) of which W 119.71 billion has been presently (December 31, 1974) paid-in in three forms -- cash, transfer of industrial shares, and conversion of earlier government loans to KDB. The amount in cash (W 66.3 billion) accounts for 55%, conversion of government loans (W 27.5 billion) for 23% and transfer of industrial shares (W 25.9 billion) for 22% of the total. Between January 1, 1972 and December 31, 1974, KDB's paid-in capital has increased by more than 100% from W 54.5 billion to W 119.7 billion. Of this increase about 87% was in the form of cash. It is expected that KDB's paid-in capital will be further raised by at least W 85 billion before the end of 1975.

4. Reserves and Retained Earnings. In terms of the provisions of its charter, KDB maintains two types of reserves - "Legal Reserve" and "Special Reserve". Until November 1968 KDB Act had required 50% of each year's net income to be paid to government and the remaining 50% to be transferred to the "Legal Reserve". After an amendment to the Act in 1968, 100% of net income is now transferred to "Legal Reserve", and the Government does not receive any dividend. The Act further provides that if in any year KDB suffers a net loss, this is to be adjusted against "Legal Reserve" and that if total amount of loss exceeds the amount of available reserve, the deficiency shall be covered by the Government. As per KDB's unaudited balance sheet as of December 31, 1974 the "Legal Reserve" stood at W 17.342 billion.

5. In December 1961, by virtue of an amendment to KDB Act, a "Special Reserve" of W 1.50 billion was created by a cash subscription by the Government. The reserve is available for absorbing any eventual losses on loans made by KDB prior to December 1961 and on its equity investment in the Readjustment Corporation (a subsidiary of KDB acting as its arrears collection agent, see Annex 8). So far net loss charged to "Special Reserve" amounts to W 6.66 million only and therefore the net balance of this reserve as of December 31, 1974 was W 1.493 billion.

6. As of December 31, 1974 the amount of unappropriated net income was W 4.1 billion (unaudited and provisional) and total "Reserves and Retained Earnings", W 22.9 billion, composed as follows:

W in billion

Legal Reserve	17.342
Special Reserve	1.493
Unappropriated Earnings	<u>4.095</u>
Total	<u>22.930</u>

7. Borrowings from the Government. This represents a major source of domestic currency resources for KDB. KDB's reliance on this source has in the recent past declined from about 46% of total domestic currency resources as of December 31, 1969 to 27% as of December 31, 1974. The Government has provided these funds in the form of annual budgetary allocations and from three sources: (a) Economic Development Fund, (b) Foreign Loan Repayment Fund and (c) Counterpart Funds.

8. Economic Development Fund represents Government's own general funds and are allocated to KDB for financing of pre-identified as well as general projects. The interest rate charged by the Government on these funds varies from 6% to 12%, with a weighted average of 6.2% as of June 30, 1974. The repayment schedules of these funds range from 5 years to 35 years. The present borrowing (W 120.5 billion as of December 31, 1974) are repayable in instalments spread up to year 2009; heaviest burden of repayment will be between 1975 and 1993 when 86% of the present outstanding borrowing will become due.

9. Foreign Loan Repayment Fund and Counterpart Fund loans represent government lending to KDB out of either grants received from abroad by the Government of Korea or counterpart funds created as a result of early repayments received from various agencies. These were lent to KDB for making equipment loans to Government projects. The interest charged by the Government on these borrowings varies between 2% to 5%; weighted average interest rate as of June 30, 1974 was 2.4%. KDB's net outstanding borrowings from these sources stood at W 16.1 billion as of December 31, 1974. No allocation of these funds has been made to KDB after 1971.

10. Industrial Finance Debentures (IFD). In terms of its Act, KDB alone can issue the IFDs. Through the instrument of these debentures, KDB attracts institutional as well as individual savings. The interest rates on IFDs is presently 12.69%. Repayment of all IFDs is secured by a government guarantee and therefore prior approval of the National Assembly is required before IFDs are issued by KDB. Duration of IFDs is medium-term (2 to 5 years) and interest is paid annually in advance. Considering the discount factor (interest for one year is deducted from the initial issue price of IFD and for the subsequent years is paid in advance) the effective weighted average interest rate on IFDs outstanding as of December 31, 1974 (W 78.6 billion) was 14%. About 42% of outstanding IFDs have been subscribed by commercial banks and financial institutions while 58% have been subscribed by general public.

11. Revolving Funds. USAID and KfW foreign currency loans to KDB have fixed amortization schedules. KDB's collections over and above its repayments are pooled in two separate revolving funds - USAID Revolving Fund and KfW Revolving Fund - and used for the financing of domestic currency loans. In order to safeguard itself against possible loss resulting from exchange rate fluctuations, KDB takes two precautions. Firstly, it relends these funds with a "Dollar/Deutsche Mark value maintenance clause" thereby passing the exchange risk on to the sub-borrowers. Secondly, it judiciously manages these funds so as to reduce to a minimum the time gap between their accrual and redisbursement. So far KDB appears to have been successful in minimizing the exchange risk associated with these funds. As of December 31, 1974 total revolving funds amounted to W 3.9 billion of which W 2.2 billion had been relent while the balance had also been committed and was to be disbursed as soon as the associated formalities were completed.

12. Special Finance Debentures. In terms of the August 3, 1972 Presidential Emergency Decree, KDB was required to lower its lending rates and to provide special loans to certain specified sectors on softer terms (8% interest rate and 5 years repayment term including 3 years of grace) so as to enable them to repay the existing loans on relatively harder terms. In pursuance of this Emergency Decree, KDB provided special loans aggregating W 27.3 billion. This in effect meant restructuring of existing loans in the sense of a longer repayment schedule and a lower interest rate. In order to compensate KDB, the Government of Korea introduced the scheme of "Special Finance Debentures". Under this scheme, the Government subscribed to KDB's Special Finance Debentures in an amount equal to KDB's special financing under Emergency Decree of August 3, 1972 (W 27.3 billion). These special debentures carry interest rate at 5.5% and are repayable in 6 to 8 years. The money received by KDB through issuance of these debentures is kept in a special deposit account with Bank of Korea. This deposit bears interest at 12.5% and therefore the mechanism of special debentures provides an interest subsidy of 7% (the differential between rates of interest income on deposit and interest payable by KDB on special debentures).

13. Industrial Rationalization Fund (IRF). This fund was also created under the Emergency Presidential Decree of August 3, 1972 for providing finances on relatively softer terms (presently 8% per annum interest and repayment term of 8 years including 3 years of grace for capital loans and one year for operating loans) for the rationalization and development of high economic priority industries. Industries eligible for obtaining finances from IRF are basic industries and those producing essential consumer goods, intermediate products, machinery and exportable products. In addition, agro-based industries such as fisheries, directly contributing to farmers' non-farm income are also eligible for financing under IRF. Although in terms of the provisions of the Presidential Decree, IRF can be used for making loans as well as investments, and for direct property acquisitions, etc., so far KDB has used it for lending purposes only.

14. IRF is administered by KDB within the broad policy guidelines formulated and laid-down by Industrial Rationalization Council which works under the control of the Prime Minister. The Council itself consists of 8 members including ministers of Economic Planning (Chairman of the Council), Finance, Agriculture and Fishery and Economic Affairs, Governors of KDB and Bank of Korea and two representatives from public designated by the President. (At present no private individual is on the Council.) In essence the function of the Council is to lay down and amend, whenever necessary, the criteria for eligibility of specific industries for IRF financing, procedural aspects and overall terms and conditions. Investment decisions relating to specific projects are taken by KDB on the basis of its appraisal of each sub-project. KDB can also lend IRF through commercial banks which would in turn relend these funds to end users at the uniform rate of 12% per annum (8% per annum up to December 7, 1974).

15. In terms of the provisions of the Presidential Decree, the resources of IRF could consist of: (a) subscriptions by Government, (b) borrowings from Government, (c) issue of Industrial Finance Debentures, (d) borrowings of foreign capital, (e) repayments received from sub-borrowers and (f) short-term borrowings from Bank of Korea in case of emergency needs. In fact only two sources have so far been tapped to raise funds for IRF - borrowings from Government and issue of Industrial Finance Debentures. Government has lent funds to IRF out of PL 480 funds (tallow imports), USAID Counterpart Funds and its direct borrowings for this purpose from Overseas Economic Cooperation Fund (OECF) and Export-Import Bank, both of Japan. The OECF and Exim Bank funds carry interest rates of 2 to 5% per annum and have long repayment periods (15 to 40 years including grace periods ranging from 5 to 10 years). These funds carry "Dollar/Yen value maintenance clause" and therefore entail exchange risk for KDB. KDB sets aside 1.5% of annual interest income under IRF financing to a special reserve to cover the potential exchange loss. Exchange fluctuation losses in excess of this reserve are to be met by the Government of Korea.

16. Industrial Finance Debentures issued by KDB under IRF (W 13.3 billion up to December 31, 1974) are identical to IFDs issued by KDB for financing its normal operations (see para 10). The negative margin on IFD funds lent under IRF arising because of higher interest cost (about 14%) than the relending rate (12%) is reimbursed to KDB by the Government of Korea.

17. Tourism Development Fund (TDF). TDF has been provided to KDB by Ministry of Transportation for financing of tourism projects such as hotels, etc. These funds, the net outstanding amount of which was W 380 million as of December 31, 1974, are provided to KDB at 6% per annum and their relending rate has been fixed by the Government at 7.5% per annum. The repayment term is eight years.

18. National Investment Fund (NIF). NIF was created by the Government of Korea on January 1, 1974 with the objective of mobilizing national savings for the financing of heavy and chemical industries during 1974-81. This fund derives its resources through government allocations and sale of

Investment Fund Bonds to National Savings Associations, newly set up National Welfare Pension Fund System, Postal Insurance and trust companies and the various public funds as may be designated by special Presidential Decree. NIF funds are available to KDB for financing heavy and chemical sectors only. Allocations out of NIF are made by Bank of Korea to KDB on an annual basis, but actual disbursements are linked with individual sub-projects. Apart for KDB, other financial institutions and commercial banks are also entitled to use NIF.

19. Borrowings (W 40.7 billion as of December 31, 1974) under NIF carry interest rate at 10.5% per annum and are relent at the pre-specified rate of 12% per annum. The repayment term of NIF is 8 years for equipment loans and 3 years for operating loans.

20. Deposits. KDB Act authorizes it to accept time deposit in domestic as well as foreign currencies and demand deposits only from its existing clients. As of December 31, 1974, KDB had time deposits of W 41.5 billion (W 7.1 billion in domestic currency and W 34.4 billion in foreign currency) and call deposits amounting to W 2.5 billion. Most of the time deposits in domestic currency came from financial institutions while almost all foreign currency deposits were made by Korea Exchange Bank out of the proceeds of its own foreign currency borrowings. On its domestic currency deposits KDB was paying interest up to January 24, 1974 at 6% for over 3 months deposits, 8.4% for over 6 months deposits, 12.0% for over 12 months deposits and 12.6% for over 24 months deposit. With effect from January 24, 1974, these rates have been raised to 12.0%, 13.2%, 15% and 15% respectively. On its foreign currency deposits, KDB pays interest at a floating rate which as at June 30, 1974 was about 10%. Funds raised through deposits (in domestic as well as foreign currencies) are used by KDB mainly for making working capital (operating) loans. Exchange risk on foreign currency deposits which are converted in domestic currency and used for financing Won currency loans is passed on to the sub-borrowers through inclusion of "Dollar value maintenance clause" in the sub-loan agreements.

Foreign Currency Resources

21. Foreign Currency Lines of Credit. KDB contracted its first foreign currency borrowing from USAID in April 1960 in the form of a line of credit of US\$5 million equivalent. This was followed by two more lines of credit aggregating US\$22.374 million (net of cancellation) obtained in 1966 and 1968. From 1966 KDB started borrowing from Kreditanstalt fur Wiederaufbau (KfW) of West Germany, which has so far provided three lines of credit aggregating DM 40 million (US\$16.5 million). KDB established its business relations with Asian Development Bank (ADB) in 1970 when it obtained a line of credit of US\$10 million equivalent. In 1972 and 1974 KDB obtained two more lines of credit of US\$20 million and US\$30 million respectively from ADB.

22. USAID and KfW loans are basically borrowings of the Government of Korea relent to KDB. The ADB loans are, however, direct borrowings of KDB against Government of Korea's guarantee.

23. Interest rates associated with the foreign currency lines of credit range between 5 to 8.5%. The first two USAID loans and first KfW loan carry interest at 5%, the third USAID loan at 6%, second KfW loan at 8%, third KfW loan at 7% and all ADB loans have variable interest rate (presently 8-1/2%). These funds have been relent by KDB with spreads ranging from 2 to 4% (weighted average 2.81%). Whereas, repayments of all ADB and first USAID loans are linked with the repayment schedules of sub-borrowers, the borrowings from KfW and USAID (last two loans) are repayable according to fixed schedules extending to 15-30 years.

24. Eurodollar Loans from Commercial Banks. KDB has so far obtained two Eurodollar loans - US\$25 million in June 1970 and US\$80 million in January 1974 (both were syndicated loans). The first loan managed by Manufacturers Hanover Ltd., London, was subscribed by 31 banks from Japan, U.S.A., K.K., Canada, Panama, Switzerland and Hong Kong and UNDP. The second loan was managed by a consortium of four banks (Banker's Trust Company of London, Citicorp International Bank Ltd., London, Asia Pacific Capital Corporation, Hong Kong, and B.T. Finance Ltd., Hong Kong), and was subscribed by 38 banks from Japan, U.K., U.S.A., Hong Kong, Singapore, Canada and Australia.

25. The first Eurodollar loan carries interest at 1.75% plus Eurodollar deposit rate prevailing in London two working days before each interest payment with a maximum of 11.75%. (Interest is paid bi-annually.) In terms of the original Loan Agreement, the interest rate was stipulated at 2% plus the inter-bank Eurodollar deposit rate, but the mark up was reduced on December 20, 1972 to 1.75% through an amendment of the Loan Agreement. The mark up over the inter-bank rate for the second Eurodollar loan is 1% but there is no fixed maximum rate. The effective interest rate on the first loan is currently 11.75% and that on the second loan 14.07%. The repayment terms of these two loans are 5 years and 10 years respectively.

26. Issuance of Industrial Finance Debentures (IFD) in Foreign Currency. In October 1974 KDB issued for the first time its IFDs in foreign currency for \$18.8 million to the Government of Abu Dhabi. These debentures carry interest at 8-1/2% and are repayable over 9 years after 6 years of grace. Issuance of IFDs in foreign currencies are expected to increase in the future.

KOREA DEVELOPMENT BANK

Terms and Condition of Long-term Borrowings as of December 31, 1974.

Source of Funds	Amount		Borrowing rate (%)	Relending rate (%)	Maximum duration for KDB (years)	Maximum duration for KDB sub-borrowers (years)	Limit on sub-loan amount	Free limit	Procurement tied or free	KDB repayment	Date of Loan Agreement
	W in billion or equivalent W in billion	US\$ in million or equivalent US\$ in million									
I. Foreign Currency											
USAID											
1st loan	2.43	5.00	5	8	10	10	\$500,000 or less	-	Tied to USA	Tied to sub-projects	April 12, 1960
2nd loan	5.51	11.37	5	8	15	15	\$100,000 to \$1.0 million	\$300,000	Tied to USA	Fixed (1971 to 1983)	Nov. 9, 1966
3rd loan	5.34	11.00	6	10	15	15	\$100,000 to \$1.0 million	\$300,000	Tied to USA	Fixed (1973 to 1985)	June 26, 1968
Sub-total	13.28	27.37									
KfW											
1st loan	4.00	8.25	5	8	20	15	DM 800,000 (\$310,500) or less (\$194,000)	DM 500,000 (\$194,000)	Free	Fixed (1971 to 1986)	Jan. 24, 1966
2nd loan	2.00	4.12	8	10	10	10	DM 200,000 (\$78,000) to DM 1.2 million (\$194,000)	DM 500,000 (\$194,000)	Free	Fixed (1972 to 1980)	Oct. 14, 1970
3rd loan	2.00	4.13	7	9	30	15	DM 200,000 (\$78,000) to DM 1.0 million (\$388,100)	DM 500,000 (\$194,000)	Free	Fixed (1986 to 2003)	Nov. 12, 1973
Sub-total	8.00	16.50									
ADB											
1st loan	4.85	10.00	Variable (7.5) ^{1/}	10	15	15	\$100,000 to \$1.0 million	\$200,000	Free	Tied to sub-projects	Nov. 23, 1970
2nd loan	9.70	20.00	Variable (7.5) ^{1/}	Borrowing rate plus 2%	15	15	\$100,000 to \$1.0 million	\$200,000	Free	Tied to sub-projects	Dec. 15, 1972
3rd loan	14.55	30.00	Variable (8.50) ^{1/}	Borrowing rate plus 2%	15	15	\$100,000 to \$2.0 million	\$500,000	Free	Tied to sub-projects	March 20, 1974
Sub-total	29.10	60.00									
Commercial banks											
1st loan ^{2/}	12.13	25.00	Inter-bank rate 3/ plus 1.75 (11.75) ^{1/}	12 to 15	5		(-----No restriction-----)		Free	Fixed (1973 to 1975)	June 9, 1970
2nd loan ^{2/}	38.80	80.00	Inter-bank rate 3/ plus 1% (14.07) ^{1/}	12 to 15	10		(-----No restriction-----)		Free	Fixed (1977 to 1984)	June 24, 1974
Sub-total	50.93	105.00									
Industrial Finance Debentures	9.12	18.80	8 1/2	12 to 15	15		(-----No restriction-----)		Free	Fixed (1980 to 1989)	Oct. 10, 1974
Total of all foreign currency borrowings	110.43	227.67									
II. Domestic Currency											
Government of Korea											
Economic development fund	120.53	248.52	6 to 12	6 to 15.5	5 to 35	No restriction	(-----Not applicable-----)			Fixed (1974 to 2009)	1962-1974
Foreign loan repayment fund	0.30	0.62	5	6 to 15.5	10	No restriction	(-----Not applicable-----)			Fixed (1974 to 1975)	1966
Counterpart funds	15.75	32.47	2 to 5	6 to 15.5	10 to 35	No restrictions	(-----Not applicable-----)			Fixed (1974 to 2009)	1962-1971
Sub-total	136.58	281.61									
Industrial Finance Debentures	78.64	162.14	10 to 12.6 (14.0) ^{5/}	12 to 15.5	2 to 5	No restrictions	(-----Not applicable-----)			Fixed (1974 to 1978)	1969-1974
Special Finance Debentures	26.72	55.09	5.5	8.0	6 to 8	8	(-----Not applicable-----)			Fixed (1973 to 1981)	1972-1973
Industrial Rationalization Fund	51.11	105.38	3 to 5 (3.6) ^{1/}	10 to 12	15 to 40	Capital loans:8 Operating loans:1	(-----Not applicable-----)			Fixed (1978 to 2012)	1972-1974
Tourism Development Fund	0.38	0.78	6.0	7.5	8	8	(-----Not applicable-----)			Fixed (1975 to 1981)	1973
National Investment Fund	40.68	83.88	10.5	12.0		Capital loans:8 Operating loans:3	(-----Not applicable-----)			Tied to sub-projects	1974
Time deposits											
Domestic currency	7.14	14.72	12 to 15	12 to 15.5	1 to 3	No restrictions	(-----Not applicable-----)			Fixed 6/	1972-1974
Foreign currency	34.39	70.91	Floating (12.5) ^{1/}	12 to 15.5	1 to 3	No restrictions	(-----Not applicable-----)			Fixed 7/	1972-1974
Sub-total	41.53	85.63									
Total of all domestic currency borrowings	375.64	774.51									
Grand total of foreign and domestic currency borrowings	486.07	1,002.18									

^{1/} Effective interest rate as of December 31, 1974.^{2/} These are Eurodollar loans; a part of the proceeds have been used for domestic currency financing.^{3/} Represents inter-bank Eurodollar deposit rate prevailing in London.^{4/} Includes Industrial Finance Debentures issued for financing under Industrial Rationalization Program.^{5/} Weighted average of interest rates discounted to allow for yearly advance payment of interest.^{6/} Repayment periods range from 1 to 3 years.^{7/} Repayment periods range from 3 months to 3 years.

KOREA DEVELOPMENT BANK

ANNEX 13

Resources Provided by Government and Raised Independently, 1969-1974
(Won in billion)

	1969				1970				1971				1972				1973				1974			
	Year-end Amount	%	Amount raised during the year	%	Year-end Amount	%	Amount raised during the year	%	Year-end Amount	%	Amount raised during the year	%	Year-end Amount	%	Amount raised during the year	%	Year-end Amount	%	Amount raised during the year	%	Year-end Amount	%	Amount raised during the year	%
I. Resources Provided by Government																								
Domestic Currency																								
Paid-in capital	27.76	19.1	7.84	16.8	50.55	23.4	22.79	32.0	54.47	21.1	3.92	9.3	110.07	26.9	55.60	37.0	110.61	23.0	0.54	0.7	119.71	19.0	9.10	6.3
Loans	58.81	40.5	17.06	36.7	69.01	31.9	10.20	14.4	86.25	33.3	17.24	40.7	101.55	24.8	15.30	10.2	116.32	24.2	14.77	20.7	136.58	21.7	20.26	14.1
Special Finance Debentures	-	-	-	-	-	-	-	-	-	-	-	-	25.77	6.3	25.77	17.2	27.27	5.7	1.50	2.1	26.72	4.3	(0.55)	(0.4)
Industrial Rationalization Fund	-	-	-	-	-	-	-	-	-	-	-	-	11.15	2.7	11.15	7.4	29.84	6.2	18.69	26.2	51.11	8.1	21.27	14.8
Tourism Development Fund	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	0.20	-	0.20	0.3	-	-	-	-
National Investment Fund	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	40.68	6.5	40.68	28.1
Subtotal	86.57	59.6	24.90	53.5	119.56	55.3	32.99	46.4	140.72	54.4	21.16	50.0	248.54	60.7	107.82	71.8	284.24	59.1	35.70	50.0	375.18	59.7	90.94	55.0
Foreign Currency																								
USAID loans	13.28	9.1	-	-	13.28	6.1	-	-	13.28	5.1	-	-	13.28	3.3	-	-	13.28	2.8	-	-	13.28	2.1	-	-
KfW loans	4.00	2.8	-	-	6.00	2.8	2.00	2.8	6.00	2.3	-	-	6.00	1.5	-	-	8.00	1.7	2.00	2.8	8.00	1.3	-	-
Subtotal	17.28	11.9	-	-	19.28	8.9	2.00	2.8	19.28	7.4	-	-	19.28	4.8	-	-	21.28	4.5	2.00	2.8	21.28	3.4	-	-
Total resources provided by the Government	103.85	71.5	24.90	53.5	138.84	64.2	34.99	49.2	160.00	61.8	21.16	50.0	267.82	65.5	107.82	71.8	305.52	63.6	37.70	52.8	396.46	63.1	90.94	55.0
II. Resources Raised Independently																								
Domestic Currency																								
Reserves and retained earnings	9.42	6.5	1.35	2.9	10.91	5.0	1.49	2.1	12.44	4.8	1.53	3.6	15.38 ^{1/}	3.8	2.94	2.0	18.84 ^{1/}	3.8	3.46	4.8	22.93	3.6	4.09	2.5
Industrial Finance Debentures	16.36	11.2	16.27	34.9	26.57	12.3	10.21	14.4	26.37	10.2	(0.20)	(0.5)	51.39	12.6	25.02	16.7	79.26	16.6	27.87	39.0	78.64	12.5	(0.62)	(0.4)
Time deposits	15.65	10.8	4.07	8.7	23.06	10.7	7.41	10.4	42.95	16.6	19.89	46.9	47.56	11.6	4.61	3.1	49.95	10.4	2.39	3.4	41.54	6.6	8.41	5.1
Subtotal	41.43	28.5	21.69	46.5	60.54	28.0	19.11	26.9	81.76	31.6	21.22	50.0	114.33	28.0	32.57	21.8	148.05	30.8	33.72	47.2	143.11	22.7	11.88	7.2
Foreign Currency																								
Industrial Finance Debentures	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	9.12	1.5	9.12	5.5
ADB loans	-	-	-	-	4.85	2.2	4.85	6.8	4.85	1.9	-	-	14.55	3.5	9.70	6.4	14.55	3.1	-	-	29.10	4.6	14.55	8.8
Commercial bank loans 3/	-	-	-	-	12.13	5.6	2.13	17.1	12.13	4.7	-	-	12.13	3.0	-	-	12.13	2.5	-	-	50.93	8.1	38.80	23.5
Subtotal	-	-	-	-	16.98	7.8	16.98	23.9	16.98	6.6	-	-	26.68	6.5	9.70	6.4	26.68	5.6	-	-	89.15	14.2	62.47	37.8
Total resources raised independently	41.43	28.5	21.69	46.5	77.52	35.8	36.09	50.8	98.74	38.2	21.22	50.0	141.01	34.5	42.27	28.2	174.73	36.4	33.72	47.2	232.26	36.9	74.35	45.0
Total of all resources	145.28	100.0	46.59	100.0	216.36	100.0	71.08	100.0	258.74	100.0	42.38	100.0	408.83	100.0	150.09	100.0	480.25	100.0	71.42	100.0	628.72	100.0	165.29	100.0
III. Resources raised/obtained since:																								
January 1, 1969	24.90	53.4	-	-	59.89	50.9	-	-	81.05	50.5	-	-	188.87	60.9	-	-	226.57	59.4	-	-	317.51	58.1	-	-
from Government	21.69	46.6	-	-	57.78	49.1	-	-	79.00	49.5	-	-	121.27	39.1	-	-	154.99	40.6	-	-	229.34	41.9	-	-
independently by KDB	46.59	100.0	-	-	117.67	100.0	-	-	160.05	100.0	-	-	310.14	100.0	-	-	381.56	100.0	-	-	546.85	100.0	-	-
January 1, 1970	-	-	-	-	34.99	49.2	-	-	56.13	49.5	-	-	163.97	62.2	-	-	201.67	60.2	-	-	292.61	58.5	-	-
from Government	-	-	-	-	36.09	50.8	-	-	57.31	50.5	-	-	99.58	37.8	-	-	133.30	39.8	-	-	207.65	41.5	-	-
independently by KDB	-	-	-	-	71.08	100.0	-	-	113.46	100.0	-	-	263.55	100.0	-	-	334.97	100.0	-	-	500.26	100.0	-	-
January 1, 1971	-	-	-	-	-	-	-	-	21.16	49.9	-	-	128.98	67.0	-	-	166.68	63.2	-	-	257.62	60.0	-	-
from Government	-	-	-	-	-	-	-	-	21.22	50.1	-	-	63.49	33.0	-	-	97.21	36.8	-	-	171.56	40.0	-	-
independently by KDB	-	-	-	-	-	-	-	-	42.38	100.0	-	-	192.47	100.0	-	-	263.89	100.0	-	-	429.18	100.0	-	-
January 1, 1972	-	-	-	-	-	-	-	-	-	-	-	-	107.82	71.8	-	-	145.62	65.7	-	-	236.46	61.1	-	-
from Government	-	-	-	-	-	-	-	-	-	-	-	-	42.27	28.2	-	-	75.99	34.3	-	-	150.34	38.9	-	-
independently by KDB	-	-	-	-	-	-	-	-	-	-	-	-	150.09	100.0	-	-	221.51	100.0	-	-	386.80	100.0	-	-
January 1, 1973	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	37.70	53.5	-	-	128.64	54.3	-	-
from Government	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	33.72	46.5	-	-	108.07	45.7	-	-
independently by KDB	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	72.42	100.0	-	-	236.71	100.0	-	-
January 1, 1974	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	90.94	55.0	-	-
from Government	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	74.35	45.0	-	-
independently by KDB	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	165.29	100.0	-	-
Total	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-

1/ These figures differ from those given in the summarized balance sheets (Annex 16) because these have been taken from KDB's unaudited balance sheets so as to maintain uniformity and comparability of figures.

2/ Including IPDS amounting to W13.33 billion issued under Industrial Rationalization Fund scheme.

3/ Including the portions used for domestic currency financing.

KOREA DEVELOPMENT BANK

Long-Term Resource Position as of December 31, 1974

(Won in millions)

Domestic Currency

Paid-in capital		119,712
Reserves and surplus		<u>22,930</u>
Net owner's equity		142,642
Borrowings from Government		136,580
Industrial Finance Debentures ^{1/}		87,755
Special loans and funds ^{2/}		118,898
Time deposits ^{3/}		<u>41,537</u>
Borrowings from foreign commercial banks used in domestic currency		<u>46,318</u>
Total domestic resources		573,730
Less: Domestic currency loans outstanding	393,673	
Investments in equity shares and industrial bonds, etc.	75,959	
Investment in fixed assets and net working capital (excluding cash and deposits) ^{4/}	<u>62,497</u>	<u>532,129</u>
Resources available for disbursements		41,601
Less undisbursed domestic currency commitments		<u>4,189</u>
Resources available for commitments		<u><u>37,412</u></u>

Foreign Currency

AID Loans		13,274
ADB Loans		29,100
KfW Loans		8,000
Commercial Banks Eurodollar Loans ^{5/}		<u>4,608</u>
Sub-total		54,982
Less: Resources disbursed/utilised		<u>37,085</u>
Resources available for disbursements		17,897
Less undisbursed foreign currency loan commitments		<u>10,124</u>
Resources available for commitments		<u><u>7,773</u></u>
<u>Total Resources</u>		
Resources available		628,712
Resources utilised/dispursed		<u>569,214</u>
Resources available for disbursement		59,498
Less: Undisbursed commitments		<u>14,313</u>
Resources available for further commitments		<u><u>45,185</u></u>

- 1/ Includes Industrial Finance Debentures issued in foreign currency, the proceeds of which are used for domestic currency financing.
- 2/ Includes borrowings from Industrial Rationalization Fund (₩51.11 billion), Tourism Development Fund (₩380 million), National Investment Fund (₩40.68 billion) and Special Finance Debentures (₩26.73 billion), for financing of pre-identified projects/sectors.
- 3/ Includes foreign currency deposits used for domestic currency financing
- 4/ Excluding credit control account (undisbursed loan commitments), and including cash deposits of ₩26.73 billion against Special Finance Debentures.
- 5/ Excluding that part which was used for domestic currency financing.

KOREA DEVELOPMENT BANK
Summarized Income Statements ^{1/}
for the years ended December 31, 1969 through 1974
(Won in million)

<u>Years ended December 31</u>	<u>1969</u>	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>
<u>INCOME</u> ^{2/}						
Interest on loans	7,810	11,654	14,566	18,356	21,089	28,453
Interest on bonds, debentures & deposits	<u>923</u>	<u>1,184</u>	<u>1,182</u>	<u>2,087</u>	<u>5,134</u>	<u>5,328</u>
Total interest income	8,733	12,838	15,748	20,443	26,223	33,781
Dividend income	471	582	750	883	2,356	2,339
Guarantee commission	1,263	2,125	3,064	3,831	3,683	4,420
Other income	73	127	275	688	411	1,144
Capital gains on sales of investments	<u>2</u>	<u>14</u>	<u>-</u>	<u>- 3/</u>	<u>- 3/</u>	<u>1,320</u>
Total income	<u>10,542</u>	<u>15,685</u>	<u>19,837</u>	<u>25,845</u>	<u>32,673</u>	<u>43,004</u>
<u>EXPENSES</u>						
Financial expenses	6,631	11,120	14,830	17,849	23,710	33,545
Administrative, personnel and other expenses	2,570	3,079	3,467	2,850	4,097	5,364
Provision for bad debts	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,261</u>	<u>1,274</u>	<u>-</u>
Total expenses	<u>9,201</u>	<u>14,199</u>	<u>18,297</u>	<u>21,960</u>	<u>29,081</u>	<u>38,909</u>
Net Income ^{4/}	<u>1,341</u>	<u>1,487</u>	<u>1,540</u>	<u>3,885</u>	<u>3,592</u>	<u>4,095</u>
<u>APPROPRIATIONS</u> ^{5/}						
Net income for the year	1,341	1,487	1,540	3,885	3,592	4,095
Transferred to legal reserve	1,341	1,487	1,540	3,885	3,592	4,095
Unappropriated balance	-	-	-	-	-	-

1/ Income statements for fiscal 1970, 1972 and 1973 are audited by external independent auditors - Messrs. Arthur Young & Co. - while those for fiscal 1969 and 1971 are audited only by KDB's own internal auditor. The results of 1974 are unaudited.

2/ Consistent with the general accounting practice followed by the banking and financial institutions in Korea, KDB reports income in its financial statements on actual receipt basis and expenses on accrual basis. The operating results summarized above are based on cash-cum-accrual basis of accounting for fiscal 1969 through 1971 and 1974, while those of fiscal 1972 and 1973 have been adjusted by external auditors to conform to accrual basis of accounting both for incomes and expenses. The net income figures of fiscal 1969 through 1971 and 1974 if adjusted to conform to accrual basis (incomes as well as expenses) of accounting, would appear as follows:

<u>Fiscals</u>		<u>1969</u>	<u>1970</u>	<u>1971</u>	<u>1974</u>
Total interest income	- Original	8,733	12,838	15,748	33,781
	- Adjusted	10,733	15,257	16,984	37,154
	- Net increase	2,000	2,419	1,236	3,373
Guarantee commission	- Original	1,263	2,125	3,064	4,420
	- Adjusted	1,413	2,332	3,354	5,136
	- Net increase	150	207	290	716
Net income	- Original	1,341	1,487	1,540	4,095
	- Adjusted	3,491	4,173	3,066	8,184
	- Net increase	2,150	2,686	1,526	4,089

3/ Capital gains realized on sales of investments (₩ 257 million in 1972 and ₩ 956 million in 1973) have been directly credited by Arthur Young & Co., to 'Legal Reserve' and not shown as part of KDB's normal income during the respective years.

4/ KDB's income is exempt from any tax.

5/ In terms of the provisions of KDB Act, the entire net income of KDB is transferred to 'Legal Reserve'. Government of Korea, which has subscribed the entire paid-in capital of KDB does not receive any dividends on its investment.

KOREA DEVELOPMENT BANK

Summarized Balance Sheets^{1/} as of December 31, 1969
through 1974
(Won in million)

As of December 31	1969	1970	1971	1972	1973	1974
ASSETS						
Current Assets						
Cash and bank deposits	5,091	10,133	10,368	23,500	15,720	31,421
Receivables, prepayments, etc. ^{2/}	6,248	9,721	22,497	46,903	50,186	46,305
Total current assets	11,339	19,854	32,865	70,403	65,906	77,726
Outstanding Loans & Investment						
Domestic currency loans	18,455	29,881	33,479	28,728	33,689	53,206
Operating loans	74,525	94,200	116,956	199,325	265,934	340,467
Capital loans						
Total domestic currency	92,980	124,081	150,435	228,053	299,623	393,673
Foreign currency loans	3,123	4,884	7,059	11,080	18,847	32,020
Total loans	96,103	128,965	157,494	239,133	318,470	425,693
Investments:						
Equity shares	26,858	46,944	48,513	63,261	58,642	65,883
Debentures	7,624	8,971	9,114	8,830	8,864	10,076
Total investments	34,482	55,915	57,627	72,091	67,506	75,959
Total portfolio	130,585	184,880	215,121	311,224	385,976	501,652
Property and equipment	941	4,599	4,876	5,467	5,332	5,059
Total assets	142,865	209,333	252,862	387,094	457,214	584,437
LIABILITIES & EQUITY						
Current Liabilities						
Deposits (short term)	8,529	7,552	5,214	6,309	5,145	2,481
Other current liabilities	2,956	8,197	7,516	7,586	10,866	17,301
Total current liabilities	11,485	15,749	12,730	13,895	16,011	19,782
Long-term Liabilities						
Special Finance Debentures ^{3/} (SFD)	-	-	-	25,770	27,267	26,726
Deduct: Equivalent deposit	-	-	-	25,770	27,267	26,726
Net liability for SFD	-	-	-	-	-	-
Deposits						
Domestic currency	15,645	23,065	20,707	11,863	12,678	7,145
Foreign currency	-	-	22,241	35,701	37,274	34,392
Total deposits	15,645	23,065	42,948	47,564	49,952	41,537
Foreign currency borrowings	3,385	13,480	17,654	20,984	23,855	63,969
Industrial Finance Debentures	16,360	26,575	26,367	51,391	79,263	87,755
Borrowings from Government of Korea	58,813	69,006	86,254	101,547	116,324	136,580
Ind. Rationalization Fund	-	-	-	11,146	29,840	51,112
Tourism Development Fund	-	-	-	-	200	380
National Investment Fund	-	-	-	-	-	40,680
Total long-term borrowings	94,203	132,126	173,223	232,632	299,434	422,013
Outstanding guarantees:						
Domestic currency	37,038	40,129	46,143	20,558	46,117	64,436
Foreign currency	262,740	384,088	554,186	590,741	741,308	1,246,705
Total guarantees	299,777	424,217	600,329	611,299	787,425	1,311,141
Deduct: Customers' liability for guarantees	299,777	424,217	600,329	611,299	787,425	1,311,141
Net liability for guarantees	-	-	-	-	-	-
Total liabilities	105,688	147,875	185,953	246,527	315,445	441,795

	<u>1969</u>	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>
<u>Equity</u>						
Paid-in-capital	27,761	50,555	54,466	110,066	110,612	119,712
Retained earnings ^{2/}	<u>9,416</u>	<u>10,903</u>	<u>12,443</u>	<u>30,501</u>	<u>31,157</u>	<u>22,930</u>
Net equity	<u>37,177</u>	<u>61,458</u>	<u>66,909</u>	<u>140,567</u>	<u>141,769</u>	<u>142,642</u>
Total liabilities & equity	<u>142,865</u>	<u>209,333</u>	<u>252,862</u>	<u>387,094</u>	<u>457,214</u>	<u>584,437</u>

1/ Balance sheets as of December 31, 1970, 1972 and 1973 are audited by external independent auditors - Messrs. Arthur Young & Co. - while those as at December 31, 1969 and 1971 are audited by KDB's own internal auditor. The balance sheet as at December 31, 1974 is unaudited.

2/ Consistent with general accounting practice followed by the banking and financial institutions in Korea, KDB reports income in its financial statements only on actual receipt basis and expenses on accrual basis. As a result income accrued and receivable is not shown in the balance sheet as an asset and on the other hand the retained earnings are understated. Except for KDB's balance sheets as at December 31, 1972 and 1973 which have been adjusted by external auditors so as to be on complete accrual basis of accounting, all other balance sheets are based on cash-cum-accrual basis of accounting. If appropriate adjustments are made for 1969 through 1971 and 1974 the following balance sheet items would be amended as indicated:

<u>As of December 31</u>	<u>1969</u>	<u>1970</u>	<u>1971</u>	<u>1974</u>
<u>A. Receivables & prepayments</u>				
As summarized	6,248	9,721	22,497	46,305
Add receivable income	<u>5,552</u>	<u>8,178</u>	<u>9,704</u>	<u>16,809</u>
Adjusted figure of receivables & prepayments	<u>11,800</u>	<u>17,899</u>	<u>32,201</u>	<u>63,112</u>
<u>B. Retained earnings:</u>				
As summarized	9,416	10,903	12,443	22,930
Add: Additional income on accrual basis	<u>5,552</u>	<u>8,178</u>	<u>9,704</u>	<u>16,809</u>
Adjusted retained earnings	<u>14,968</u>	<u>19,081</u>	<u>22,147</u>	<u>39,739</u>

3/ This is a fixed deposit against the outstanding balance of Special Finance Debentures and can be used only for redemption of these debentures.

KOREA DEVELOPMENT BANK

Indicators^{1/} of Financial Position and Operational Performance
(Won in million)

Years ended December 31	1969		1970		1971		1972		1973		1974	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
I. Total Assets ^{2/}	142,865		209,333		252,865		387,094		457,214		584,437	
Of which loan portfolio	96,103	67	128,965	62	157,494	62	239,133	62	318,470	70	425,693	73
Investment portfolio	34,482	24	55,915	27	57,627	23	72,091	19	67,506	15	75,959	13
Total long-term debts ^{2/}	94,203		132,126		173,223		232,632		299,434		422,013	
Of which in foreign exchange	3,385	4	13,480	10	17,654	10	20,984	9	23,855	8	63,969	15
Borrowings from Govt.	58,813	62	69,006	52	86,254	50	101,547	44	126,324	39	136,580	32
Debentures	16,360	17	26,575	20	26,367	15	51,391	22	79,263	26	87,755	21
Special loans and funds	-	-	-	-	-	-	11,146	5	30,040	10	92,172	22
Deposits	15,645	17	23,065	18	42,948	25	47,564	20	49,952	17	41,537	10
Equity	37,177		61,458		66,909		140,567		141,769		142,642	
Long-term debt/equity	2.5		2.2		2.6		1.7		2.1		3.0	
Total debt/equity	2.8		2.4		2.8		1.8		2.2		3.1	
Long-term debt (including guarantees)/equity	10.9		9.2		11.7		6.0		7.7		11.7	
Current ratio	1.0		1.3		2.6		5.1		4.1		3.9	
Acid test ratio	0.44		0.64		0.81		1.69		0.98		1.59	
II. Profit before provisions as % of average total assets	1.0		0.9		0.7		1.6		1.2		0.8	
Net income ^{3/} after provisions as % of average equity	4.1		3.0		2.4		3.7		2.5		2.9	
Reserves & provisions as % of total portfolio	7.3		6.1		5.9		9.9		8.2		4.6	
Financial expenses as % of average total assets	5.0		6.4		6.6		5.6		5.6		6.4	
Administrative expenses as % of average total assets	2.0		1.8		1.5		0.9		1.0		1.0	
Book value as % of par value	133		122		123		128		128		119	
Gross earnings as % of average assets	8.0		9.1		8.8		8.1		7.7		8.3	
Debt service coverage (times)	4.0		1.32		1.29		2.19		1.26		N.A.	
Interest on term debt as % of average term debts	8.0		7.6		8.3		8.2		8.3		8.2	
Cost of total term resources ^{4/} as % of average total resources ^{4/}	5.7		5.3		5.6		5.5		5.5		5.9	
Income from loan portfolio as % of average loan portfolio	9.6		10.4		10.2		9.3		7.6		7.7	

^{1/} Indicators for fiscal 1972 and 1973 are not realistically comparable with those of other fiscals as financial statements of these fiscals were prepared on accrual basis as against cash basis of accounting for incomes and accrual basis for expenses used for the remaining fiscals.

^{2/} Excluding guarantees.

^{3/} KDB's income is exempt from tax.

^{4/} Including owner's equity.

KOREA DEVELOPMENT BANK

Projections of Approvals, Commitments and Disbursements, 1975-1979
(Won in million)

Years ending December 31	1975	1976	1977	1978	1979
<u>Approvals</u>					
Domestic currency loans					
Operating loans	28,515	30,520	32,660	34,940	37,380
Capital loans	<u>114,064</u>	<u>122,080</u>	<u>130,540</u>	<u>139,750</u>	<u>149,520</u>
Total domestic currency loans	142,580	152,600	163,300	174,700	185,900
Foreign currency loans	<u>33,548</u>	<u>40,100</u>	<u>33,250</u>	<u>42,100</u>	<u>42,100</u>
Total loans	176,128	192,700	196,550	216,800	229,000
Investments 1/	<u>10,140</u>	<u>16,000</u>	<u>18,000</u>	<u>20,000</u>	<u>22,000</u>
Total approvals	<u>186,268</u>	<u>208,700</u>	<u>214,550</u>	<u>236,800</u>	<u>251,000</u>
<u>Commitments 2/</u>					
Domestic currency loans					
Operating loans	27,206	30,360	32,490	34,756	37,186
Capital loans	<u>108,825</u>	<u>121,440</u>	<u>129,960</u>	<u>139,024</u>	<u>148,744</u>
Total domestic currency loans	136,031	151,800	162,450	173,780	185,930
Foreign currency loans	<u>32,697</u>	<u>39,840</u>	<u>33,520</u>	<u>41,750</u>	<u>42,100</u>
Total loans	168,728	191,640	195,970	215,530	228,030
Investments	<u>9,577</u>	<u>15,770</u>	<u>17,920</u>	<u>19,920</u>	<u>21,920</u>
Total commitments	<u>178,305</u>	<u>207,410</u>	<u>213,890</u>	<u>235,450</u>	<u>249,950</u>
<u>Disbursements 3/</u>					
Domestic currency loans					
Operating loans	27,206	30,360	32,490	34,756	37,186
Capital loans	<u>108,825</u>	<u>121,440</u>	<u>129,960</u>	<u>139,024</u>	<u>148,744</u>
Total domestic currency loans	136,031	151,800	162,450	173,780	185,930
Foreign currency loans	<u>21,657</u>	<u>36,270</u>	<u>36,680</u>	<u>37,630</u>	<u>41,930</u>
Total loans	157,688	188,070	199,130	211,410	227,860
Investments	<u>9,577</u>	<u>15,770</u>	<u>17,920</u>	<u>19,920</u>	<u>21,920</u>
Total disbursements	<u>167,265</u>	<u>203,840</u>	<u>217,050</u>	<u>231,330</u>	<u>249,780</u>

1/ Includes investment in equity shares, bonds and debentures.

2/ Domestic currency loans and investments are projected to get committed on an average one month after approval and foreign currency loans 15 days after approval. In other words 92% of domestic currency loan and investment approvals and 96% of foreign currency loan approvals of each year are projected to be committed in the same year and the balance in the following year. This represents KDB's loan commitment experience in the past.

3/ In respect of its domestic currency loans, it is KDB's practice to fully credit the sub-borrower's loan account soon after the sub-loan agreement is signed. Therefore KDB's domestic currency loan disbursement are projected to be equal to yearly commitments. Foreign currency loans are projected to get disbursed 6 month after commitment i.e. 50% each in the year of commitment and in the following year. 100% of yearly commitments for investments are projected to get disbursed in the same year.

KOREA DEVELOPMENT BANK
Projected Balance Sheets, 1975-1979
(Won in million)

<u>As of December 31</u>	<u>1974</u> ^{1/} <u>(Actual)</u>	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>
ASSETS						
Current Assets						
Cash and bank deposits	31421	44055	51061	68216	79452	102570
Receivable, prepayments etc.	46305	50291	55191	63891	72891	82291
Total current assets	77726	94346	106252	132107	152343	184861
Long-term Assets						
Portfolio:						
Domestic currency capital loans	340467	433301	531150	626907	722092	817553
Domestic currency operating loans	53206	67625	82896	97841	112636	127595
Total domestic currency loans	393673	500926	614046	724748	834788	945148
Foreign currency loans	32020	48985	81190	111132	139539	169888
Total loans	425693	549911	695236	835880	974327	1115036
Less: Provision for doubtful accounts	-	600	1200	1800	2400	3000
Net loans	425693	549311	694036	834080	971927	1112036
Investments	75959	79090	88230	97450	106600	115690
Total portfolio	501652	628401	782266	931530	1078527	1227726
Property and equipment	5059	5525	6355	9155	11855	13455
Total assets	584437	728272	894873	1072792	1242725	1426042
LIABILITIES & SHAREHOLDER'S EQUITY						
Current Liabilities						
Short-term deposits	2461	2592	2792	2992	3192	3392
Other current liabilities	17301	17821	18421	19021	19621	20221
Total current liabilities	19782	20413	21213	22013	22813	23613
Long-term Liabilities						
Time deposits:						
Domestic currency	7145	7208	7308	7408	7508	7608
Foreign currency	34392	20360	9603	3163	1007	-
Total deposits	41537	27568	16911	10571	8515	7608
Foreign currency borrowings	63969	78414	127878	171155	213136	254366
Industrial Finance Debentures:						
Domestic currency	78631	76891	71838	77402	77402	77402
Foreign currency	9124	57623	81873	106123	130373	154623
Total Industrial Finance Debentures	87755	134514	153711	183525	207775	232025
Special Finance Debentures	26726	23991	18511	13026	7541	2056
Deduct: Equivalent deposit	26726	23991	18511	13026	7541	2056
Net liability	-	-	-	-	-	-
Borrowings from:						
Government of Korea	136580	72665	105843	137563	164843	191777
National Investment Fund	40680	100690	157470	214552	273262	334762
Industrial Rationalization Fund	51112	56084	52325	52267	50507	49554
Tourism Development Fund	380	380	380	380	380	380
Total long-term liabilities	422013	470305	614518	770013	918418	1070472
Total liabilities	441795	490718	635731	792026	941231	1094085
Outstanding Guarantees:						
Long-term guarantees for:						
Public sector ^{2/}	1076874	2364500	2482790	2606930	2737280	2874140
Private sector	177085	351501	369080	387530	406900	427240
Short-term guarantees	57183	63100	66260	69570	73050	76710
Total guarantees	1311142	2779161	2918130	3064030	3217230	3378090
Deduct:						
Customers' liability for guarantees	1311142	2779161	2918130	3064030	3217230	3378090
Net guarantees	-	-	-	-	-	-
Shareholder's Equity						
Paid-in capital	119712	206188	216188	226188	236188	256188
Reserves	22930	31366	42954	54578	65306	75769
Total shareholder's equity	142642	237554	259142	280766	301494	331957
Total liabilities & shareholder's equity	584437	728272	894873	1072792	1242725	1426042

1/ Unaudited

2/ Represents guarantees issued by KDB for public sector projects as well as those for private sector projects with high economic priority. Final credit risk in respect of these guarantees shall be borne by the Government of Korea in terms of the Guarantee Release Arrangement and therefore not counted as debts for purposes of debt/equity ratio calculations.

KOREA DEVELOPMENT BANK

Projected Income Statements, 1974-1978
(Won in million)

Years ending December 31	1974 ^{1/} (Actual)	1975	1976	1977	1978	1979
Income:						
Interest Income						
Loans	28,453	41,256	53,930	67,217	80,258	93,391
Bonds and debentures	776	1,231	1,404	1,555	1,698	1,833
Deposits	4,552	5,390	4,876	4,191	3,505	2,820
Total interest income	33,781	47,877	60,210	72,963	85,461	98,044
Dividend income	2,339	2,065	2,208	2,451	2,696	2,942
Capital gains on sale of shares	1,320	1,300	1,500	1,700	1,900	2,500
Guarantee commission	4,420	8,615	9,046	9,498	9,973	10,472
Miscellaneous income	1,144	1,080	1,380	1,680	1,980	2,680
Total Income	43,004	60,937	74,344	88,292	102,010	116,638
Expenses:						
Interest on borrowings and deposits	33,545	45,541	55,036	68,088	81,722	95,487
Provision for bad and doubtful accounts	-	600	600	600	600	600
Salaries and other personnel expenses	3,100	4,030	4,640	5,330	6,120	7,038
Other administrative & general expenses	2,264	2,330	2,480	2,650	2,840	3,050
Total Expenses	38,909	52,501	62,756	76,668	91,282	106,175
Net Income ^{2/}	4,095	8,436	11,588	11,624	10,728	10,463
Appropriation:						
Transfer to Legal Reserve ^{3/}	4,095	8,436	11,588	11,624	10,728	10,463

^{1/} Unaudited^{2/} KDB's income is exempt from tax^{3/} KDB Act provides for transfer of entire net income of each year to be transferred to "Legal Reserve."
No dividends are therefore payable.

KOREA DEVELOPMENT BANK

Projected Cash Flow, 1975-1979
(Won in million)

<u>Years ending December 31</u>	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>
<u>Sources</u>					
Net income	8,436	11,588	11,624	10,728	10,463
Add back: Depreciation and provisions for doubtful debts	928	970	1,000	1,100	1,200
Increase in share capital	86,476 ^{1/}	10,000	10,000	10,000	20,000
Draw-down on foreign currency borrowings	19,232	52,820	52,330	52,280	55,580
Increase in domestic currency borrowings from:					
Government of Korea	24,815	35,000	34,000	30,000	30,000
National Investment Fund	60,000	62,200	70,300	79,400	89,700
Industrial Rationalization Fund	11,485	-	3,000	6,000	5,000
Total increase in domestic currency borrowings	96,300	97,200	107,300	115,400	124,700
Issue of new Industrial Finance Debentures					
Domestic currency	16,286	30,000	30,000	30,000	30,000
Foreign currency	48,500	24,250	24,250	24,250	24,250
Total issue of new Industrial Finance Debentures	64,786	54,250	54,250	54,250	54,250
Sale of investments	6,446	6,630	8,700	10,770	12,830
Increase in current liabilities ^{1/}	494	700	700	700	700
Collections against:					
Domestic currency loans	28,778	38,680	51,748	63,740	75,570
Foreign currency loans	4,692	4,065	6,738	9,223	11,581
Total collections	33,470	42,745	58,486	72,963	87,151
Total sources	316,568	276,903	304,390	328,191	366,874
<u>Uses</u>					
Additional investment in property and equipment	594	1,000	3,000	3,000	2,000
Disbursement of:					
Domestic currency loans	136,031	151,800	162,450	173,780	185,930
Foreign currency loans	21,657	36,270	36,680	37,630	41,930
Total loan disbursements	157,688	188,070	199,130	211,410	227,860
New investments	9,577	15,770	17,920	19,920	21,920
Repayments of:					
Foreign currency borrowings	4,787	3,356	9,053	10,299	14,350
Domestic currency borrowings from:					
Government of Korea	88,730 ^{1/}	1,822	2,280	2,720	3,066
National Investment Fund	-	5,410	13,218	20,590	28,200
Industrial Rationalization Fund	6,514	3,759	3,058	7,760	5,953
Total repayments	109,508	30,117	45,529	51,389	73,489
Redemption of:					
Industrial Finance Debentures:					
Domestic currency	18,026	35,053	24,436	30,000	30,000
Foreign currency	-	-	-	-	-
Special Finance Debentures	2,735	5,480	5,485	5,485	5,485
Foreign currency deposits	14,032	10,757	5,440	2,156	1,007
Total redemptions	34,793	51,290	36,361	37,641	36,492
Increase in receivable, prepayments etc.	3,286	4,900	8,700	9,000	9,400
Decrease in current liabilities ^{1/}	-	-	-	-	-
Total uses	306,669	375,377	292,720	322,440	349,241
Cash increase during the year	9,899	1,526	11,670	5,751	17,633
Previous year's cash balance ^{3/}	58,147	68,046	69,572	81,242	86,993
Cash balance at the end of the current year	68,046	69,572	81,242	86,993	104,626

^{1/} Includes conversion of W 85.0 billion of Government loans into share capital.^{2/} Includes all current liabilities and long-term domestic currency deposits.^{3/} Including cash deposit against Special Finance Debentures.EAP Projects Department
February 26, 1975

KOREA DEVELOPMENT BANK

Projected Financial and Operating Ratios, 1975-1979
(Won in million)

Years	1974 (Actual)	1975	1976	1977	1978	1979
	Amount %	Amount %	Amount %	Amount %	Amount %	Amount %
I. Total Assets	584,437	728,272	896,873	1,072,792	1,242,725	1,426,042
Of which loan portfolio ^{1/}	425,633	549,311	684,936	834,080	971,927	1,112,036
Investment portfolio	75,939	79,080	88,230	97,450	106,600	115,690
Total long-term debts and guarantees	422,013	470,305	614,318	770,013	918,418	1,070,472
Total long-term debts and guarantees	63,969	78,414	127,878	171,155	213,136	254,366
Of which in foreign exchange	136,580	136,580	105,843	137,563	164,843	191,777
Borrowings from Government	87,735	87,735	134,514	183,525	207,775	232,025
Debentures	92,172	137,144	210,175	267,199	324,149	384,686
Special loans and funds	41,537	27,568/	16,911	10,571	8,515	7,608
Deposits	1,253,959	331,5012/	369,080	387,530	406,900	427,240
Outstanding long-term guarantees	142,642	237,554	259,142	280,766	301,494	331,957
Equity	11.7	3.5	3.8	4.1	4.4	4.5
Long-term debt ^{2/} /equity	12.3	3.8	4.1	4.4	4.7	4.8
Total debt ^{2/} /equity	3.9	4.6	5.0	6.0	6.7	7.8
Current ratio						
Acid test ratio	1.59	2.16	2.41	3.10	3.48	4.34
II. Profit before provisions as % of average total assets	0.8	1.5	1.5	1.2	1.0	0.8
Net income as % of average equity	2.9	4.4	4.7	4.3	3.7	3.3
Reserves and provisions as % of total portfolio	4.6	5.1	5.6	6.1	6.3	6.4
Financial expenses as % of average total assets	6.4	7.5	6.8	6.9	7.1	7.2
Administrative expenses ^{4/} as % of average total assets	1.0	1.0	0.9	0.8	0.8	0.8
Book value as % of par value	119	115	120	124	128	130
Gross earnings as % of average assets	8.3	10.1	9.2	9.0	8.8	8.7
Debt service coverage (times)	N.A.	0.9	0.9	1.01	1.0	1.0
Cost of term debt as % of average term debts	8.2	9.3	9.4	9.2	9.2	9.2
Cost of total term resources ^{5/} as % of average term resources	5.9	6.5	6.5	6.6	6.8	7.0
Interest income from loan portfolio as % of average loan portfolio	7.7	8.5	8.7	8.8	8.9	8.9

^{1/} Net of provisions for doubtful accounts^{2/} Including guarantees^{3/} Decline in guarantees as compared to 1974 is due to going into effect of Guarantee Release Arrangement.^{4/} Includes salaries and personnel, administrative and general expenses.^{5/} Term debts plus equity.

EAP Projects Department

February '76, 1975

KOREA DEVELOPMENT BANK

Schedule of Projected Draw-Downs from Proposed Bank Loan^{1/}
 (US\$ in millions)

1975

January - March	-
April - June	-
July - September	0.50
October - December	<u>1.00</u>
Sub-total	<u>1.50</u>

1976

January - March	2.50
April - June	4.50
July - September	8.00
October - December	<u>12.00</u>
Sub-total	<u>27.00</u>

1977

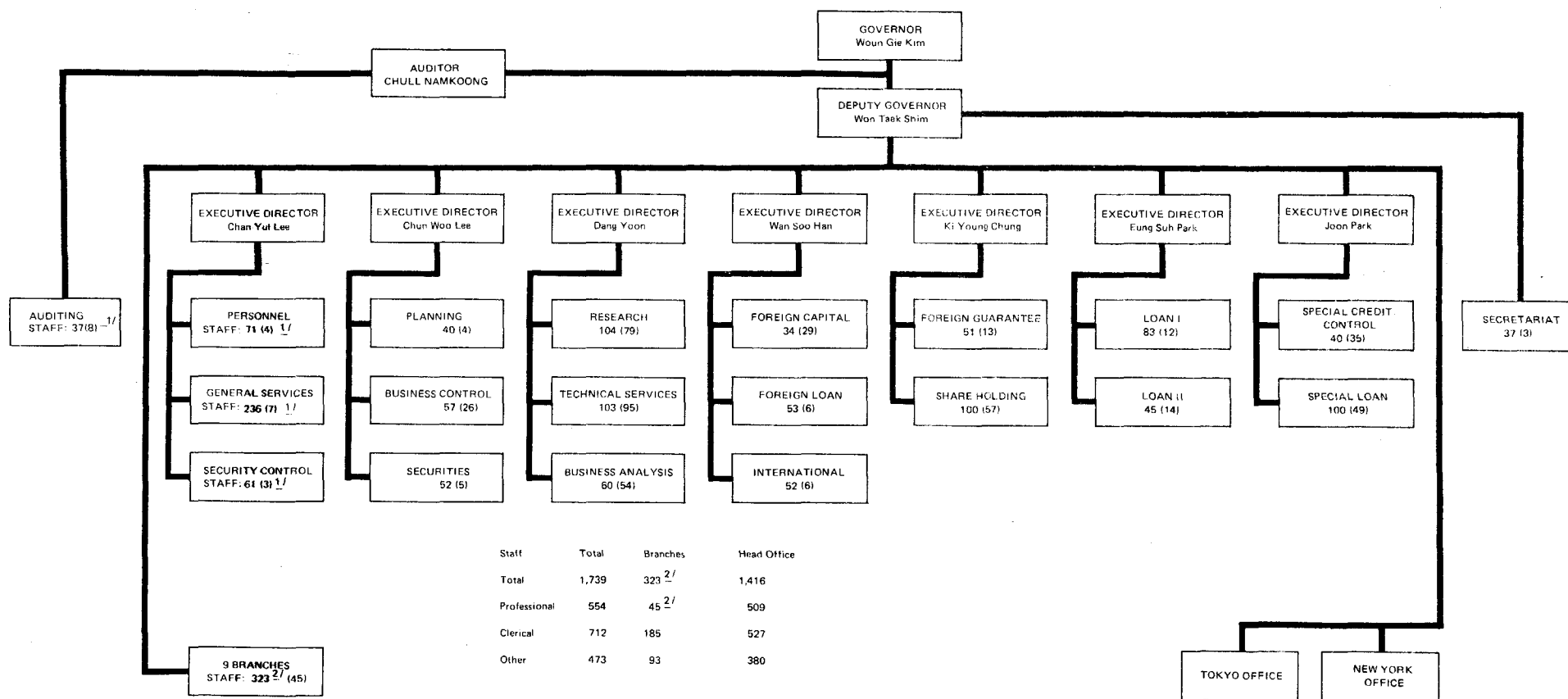
January - March	12.00
April - June	8.00
July - September	<u>5.50</u>
October - December	<u>4.00</u>
Sub-total	<u>29.50</u>

1978

January - March	1.50
April - June	<u>0.50</u>
Sub-total	<u>2.00</u>
Total	<u><u>60.00</u></u>

^{1/} Assuming that the loan shall become effective before July 1975.

**KOREA DEVELOPMENT BANK
ORGANIZATION CHART AS OF MAY 31, 1974**



1/ Numbers in parentheses indicate professional staff.
2/ Including Representative Offices, and seconded staff (2).

EAP Projects Department
February 26, 1975

World Bank-9062(R)